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# **INHERENT DEFECT INSURANCE**

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## INTRODUCTION

**The main purpose of the paper is to make a comparative study of the current situation in respect of compulsory decennial insurance , where it exists as in France , Spain , Italy ... and Inherent Defect Insurance in other territories ( such as Belgium) where there is no obligation by law but an active market to offer latent defects insurance on certain projects.**

Ever since the birth of humanity, people have devoted a large part of their efforts and resources to protecting themselves against the elements – rain, snow, wind and/or sun – which explains why homes have always been a fundamental possession during a lifetime and even beyond.

About 3.500 years ago the Hammurabi – *King of Babylon* - Code ) was well aware of how important their homes were to his subjects and proclaimed a law laying down the strictest penalties for incompetent builders :

- . if the house that has been built collapses and kills the owner, the Architect shall be punishable by death
- . if the contents have been destroyed, he must restore what has been destroyed and, because he did not make the building strong and it collapsed, he must rebuild the house at his own expense... »

Many years later in France, when the Civil Code was established (1804), liability specific to builders was defined :

Article 1792 : «If the building constructed for a fixed price is destroyed completely or partially through a structural defect, even resulting from a flaw in the ground, its architects and builders shall be liable for ten years.»

Article 2270 : « After ten years, the architect and the builders shall be released from guarantees associated with construction works which they have undertaken or of which they were in charge. »

In the whole world, builders, in order to satisfy their clients, have tried to make sure that their works lasted after they were gone, or even for eternity - witness the Pyramids in Egypt, the cathedrals in Europe, temples throughout the world.....

Through the centuries builders have usually used time-honoured construction methods without much innovation.

Nevertheless each building remained a prototype, because as it was finalized during its construction. The conditions under which it was built differed on each occasion (soil conditions, principals requirements, climate...). A prototype which was produced moreover not by a small team, but by a whole host of individuals who had to be co-ordinated by the architect.

But with the recent world population explosion, demand for housing, infrastructure and industrial plants has grown apace and the land area naturally suited to building has shrunk. On top of this, as general living standards have risen, people have come to expect higher standards of comfort and safety. Consequently, builders have had to come up with imaginative solutions to new technical problems and design new materials to meet these new demands.

It follows that the higher technical level of new construction projects makes them more vulnerable to deterioration over time and their owners sometimes find themselves in dire straits when their property has to undergo radical repair or rebuilding.

## Modern Buildings

The doubling of the world population over the past 50 years and the economic growth in many countries (in the thirty post-war years for the OECD countries and more recently for the Asian economies) have greatly expanded the need for housing, industrial plants and infrastructure.

However, most good building land – sheltered sites on rocky terrain and large expanses of flat ground – has already been occupied. The sites « chosen » today may need major earthworks, special foundations or drainage. In some places, economic necessity has forced developers to reclaim land from the sea, as in the case of Hong Kong airport. This means that the foundations for new buildings require more sophisticated and therefore more risk-prone technology, such as extremely deep piling.

High demand for buildings means they have to be erected more quickly, while at the same time providing the improved quality required by consumers. Builders have therefore had to develop new materials to meet these challenges. One example is reinforced concrete, invented at the end of the nineteenth century, which replaced stone vaulting, wooden roof beams and brick walls ; and which in its modern, increasingly high-performance versions enables builders to reduce the thickness of loadbearing walls and cut construction times.

A number of other materials have been introduced to meet economic needs and satisfy consumer demand, such as curtain walls and heat and sound insulation, but many of them have not been in use long enough to say how durable they will be.

When we talk of a new building, we can often say it is a prototype, or at least a one-off construction, with all the consequences that this implies. Each building requires an individual study taking into account its location and the loads it will have to bear throughout its lifetime. Innovative construction methods and new materials, or standard products used in a non-traditional way, will be used to meet architectural requirements or economic needs. An example is the Grande Arche at La Défense, Paris, which was built using a revolutionary construction method and high-strength concrete, with thin marble sheet cladding, a first use of this material on such a large scale.

When we talk of a new building, we can often say it is a prototype, or at least a one-off construction, with all the consequences that this implies. Each building requires an individual study taking into account its location and the loads it will have to bear throughout its lifetime. Innovative construction methods and new materials, or standard products used in a non-traditional way, will be used to meet architectural requirements or economic needs.

Moreover, in contrast to the way prototypes are produced in other industries, such as car manufacturing, a new building is often the product of a large number of different trades, each employing workers who are often low-skilled and transient, and sometimes working in bad climatic conditions, consequently the probability of achieving zero-fault performance in the building industry is virtually nil, even if the contractor has employed all the resources he thought necessary to do the job well.

After looking at buildings from a technical point of view, we will now consider how their future owners regard them. Whether they are having a house, office block or factory built, the primary consideration is cost. Any building is first and foremost an important financial commitment that will be amortized over the long term. Once the work is finished, any major fault in the building can become an unbearable financial burden and may, in extreme cases, lead to bankruptcy. It is in the owners' interest to protect themselves against major construction faults because even if

they are not responsible for causing the defects, but they will always have to bear the consequences.

Today more than ever before, principals can find themselves in a difficult position :

- every construction operation generates a risk of defect which cannot be ignored ;
- making good such defects can prove very costly (the possible « savings » realized during the erection of the building and the actual cost of the repairs which neither the builder nor the owner can perhaps bear, are out of all proportion to one another).

All of these reasons have caused the legislators, at least in some countries, to lay down some very precise rules for builders.

For example, specific builders' liability over a period of 5 or 10 years :

- Belgium : art. 1792 and 2270 of the Civil Code
- Brazil art. 1245 of the Civil Code
- Canada art 1688 of the Civil Code
- Colombia art 2060 3a of the Civil Code
- Spain art 1591 of the Civil Code
- Philippines art 1723 of the Civil Code
- Saudi Arabia Decree m14 of Mach 27<sup>th</sup> 1977 (7.4.1397 A H)
- Tunisia Law 94-9 of January 31<sup>st</sup> 1994

This list is obviously not exhaustive. The Victorian Building Act of 1993 in Australia as well as legislation in Queensland and New South Wales is also worthy of mention.

In other countries, builders are subject to general rules as regarding their liability.

But very few countries require them to insure against their liability. Those that do include France, Sweden, the State of Victoria in Australia, Tunisia, the State of New Jersey in the USA, the date of British Columbia in Canada, Finland from September 1<sup>st</sup>, 1998, Spain from November 5<sup>th</sup>, 1999 and Italy from July 27<sup>th</sup>, 2000.

The problems encountered by the principals in the event of damage to their buildings, as outlined in this paper, thus remain unresolved in most countries.

In most cases those responsible for defects in a building are those involved in its construction (architects, design consultants, contractors and manufacturers), either because of faulty design, poor workmanship, low-quality materials, incorrect use of materials, or a combination of the above.

In the event of damage the first step is to contact the company responsible for the defect and request rectification of its errors or bad workmanship. But this is not always possible, as the company may no longer exist, and even if the contractor is still in business he may not have the resources or the willingness to remedy the defect. To overcome this problem it may be worthwhile to insist on builders taking out liability insurance to cover their activities. But legal liability policies generally exclude the defective structure itself and cover only consequential loss, and require the owner to provide proof of negligence. This solution may be logically sound (those responsible for damage to a building must be insured), but it leaves the owner of the defective building with a few problems.

He must first of all establish who is responsible for the loss, which is not always easy and can take some time. There may be several levels of liability, resulting in a battle to apportion the blame, which is often taken to court and is in any case a long-drawn-out affair. During this time the damage will not have been repaired.

Even then it is not certain that the contractor found liable will still be in business, that he is solvent or that he is still insured. Finally, cover limits may prove inadequate to carry out all the repair work needed.

To overcome the above difficulties, the owner may choose to take out a policy covering him against loss due to major structural defects over a sufficiently long period : that is Inherent Defect Insurance.

# I – COUNTRIES WITH LEGAL BUILDER'S LIABILITY AND WITH COMPULSORY DECENNIAL INSURANCE

## 1 FRANCE

### LEGAL ENVIRONMENT

In France, the Civil Code gives a legal system for decennial liability: There are the articles 1792 & 2270.

This liability concerns the builders i.e. the contractors, the architects, the engineers and the manufacturers.

It applies to all types of construction works.

It is a strict liability for ten years (art. 1792-1) from practical completion. This liability targets structural defects or non-structural defects if works are "unfit for their intended purpose".

In addition, there is a guarantee of 2 years from practical completion of the works for building (art. 1792-3) equipment defects.

From 1978, the French insurance Code says that this liability must be insured by a compulsory insurance for building works. Moreover, all developers and owners must also take an insurance policy for the decennial damages.

### INSURANCE

- The principals (owners)  
The Insurance policy for the principals is a first party policy for damages for which builders are legally liable according to the art. 1792 of Civil Code but not according to the art. 1792.3  
No deductible applies. There are very strict settlement dead lines : 30 days for the first report and 90 days for the payment from claims advice.  
The loss limit is the total cost of the construction.
- The builders  
The Insurance policy for the builders is a third party liability policy for their legal liability defined by the art. 1792 of the Civil Code but not by the art.1792-3.  
The loss is wholly paid to the third party, then the insurer recovers the deductible from the builder.  
There is no settlement dead line but there is an agreement between insurers for settlement of claims.  
The usual loss limit is M Euro 10 for contractors and is M Euro 1.5 for engineers.

This compulsory insurance works in two triggers :

The first one is the owner damage cover.

The principle is to pay first in order to protect the consumer interests, before any search for liability.

The second one is the contractors/engineers liability insurance in order to maintain contractors/engineers involvement.

Moreover, there is an obligation for the agreed by the state insurers to insure. (Quotation Committee).

If for any reason, all insurers refuse the risk, there is a special Quotation Committee that gives a quotation and names an insurer.

### POLICY WORDING

As we have said above, there are 2 types of policies :

- Dommage ouvrage (DO)  
The insured is the principal of the building  
"Authorized" exclusions are
  - fraudulent acts, theft
  - external causes : fire, earthquake, ...
  - normal action of the time
  - war

The loss limit is the total cost of the works with full indexation

- Liability cover  
It is the contractor liability according to art. 1792  
The insured is the builder  
The "authorized" exclusions are - external cause : fire, earthquake
  - war
  - rules of art (not opposable to third party)
 There is no compulsory loss limit.

In fact, there are different forms of policies :

- DO (Dommage Ouvrage) is always issued for a single project cover
- "Constructor liability" is issued either on annual basis
- "PUC" (police unique de chantier) is issued for one specific single project including both "Dommages Ouvrage" plus "Contractor Liability" in the same policy.

## **EXPERIENCE**

Since the French law has been designed, insurers have been confronted with many difficulties.

- The scope of the cover is not totally defined and relies on the courts interpretations  
What is a building?  
What is the meaning of "unfit for its intended purpose"?
- The absence of deductible encourages a claim attitude
- The liability deductible is not opposable and makes insurers dependent from economic situation

Those changing parameters make very difficult the assessment of the risk and the calculation of the long insurance period.

In addition

- Courts interpretations make the cover broader and broader

It is good consumer's protection but up today a non profitable product for insurers.

## **STATISTICS**

From 1983 to 1996, the total market premium was MMUS\$ 8. The total market losses were reported up to MMUS\$ 2. Since 1994, the increase of average rate has been 50 %. In average, the increase of claims was 10 % per year since 1983. The number of claims closed without payment was 50 %. But those claims were adjusted by construction loss adjusters, and fees were paid.

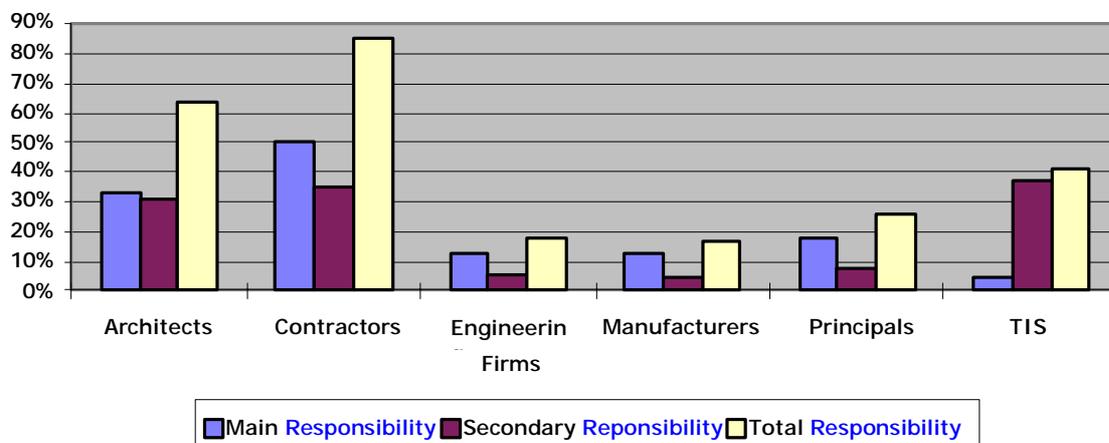
The costs can be split according to the parts of the building

- Structural works : 60 %
- Non structural works : 35 %
- External works : 5 %

These figures are according to the specificity of the French cover and according to the specific of the French professional organisation. They cannot be easily extrapolated to other markets.

- Contractors with professional classification
- Products agreed by technician (norm/Technical Advice) and reviewed by insurers
- Quality control in factory and on site
- Technical inspection

### Responsibility



## 2 SPAIN

### Law 38/1999, 5<sup>th</sup> of November – Building arrangement. Valid from 5-5-2000

The goal of this law consists in regulating the construction process taking into account the essential aspects. Therefore, the obligations and responsibilities of the operating agents are established as well as the warranties that are necessary for its development, assuring the quality by fulfilling the basic requirements of the buildings and protecting appropriately the interests of the consumers.

Scope of application: The construction, i.e. the action and the result of constructing a building of public or private permanent nature:

For the purposes of this law, the following concepts will be considered as construction:

- Works of new buildings
- Works of extension, modification, renovation or rehabilitation that change the architectural configuration of the buildings. These works are considered as such provided there is a complete intervention or a partial one that produces an essential change of the general exterior composition, volume, or the whole structural system, or changes in the characteristic use of the building.

#### Basic Requirements of the construction

##### Regarding functionality:

- Utilisation
- Accessibility
- Access to service items

##### Regarding security:

- Structural security
- Security in case of fire
- Use security

##### Regarding habitability:

- Hygiene, health and environmental protection
- Noise protection
- Energy saving and heat isolating

##### Time Terms:

The calculation of the liability and warranty terms established by this law would begin from the date on which the certificate of acceptance is issued.

##### Construction Agents

The principal, the planner, the constructor, the director of the work site, the building owner, the quality control entities and laboratories of the construction, the product deliverer, the consumer.

##### Liabilities and Warranties:

Liability of the agents taking part in the building process:

The persons taking part in the construction process will be liable:

During ten years: for the material damages due to fault or defect in the building that might affect the basement, the beams, the walls and other structural elements as well as those affecting directly the mechanical resistance and stability of the building.

### **Compulsory insurance**

Material damage insurance in order to guarantee the material damages caused by fault or defect to the building, provided that these faults are originated or affect the basement, the beams, the walls or other structural elements, affecting directly as well the mechanical resistance and stability of the building. This insurance will cover a period of ten years. As soon as the law is in course, this warranty can be requested for buildings designed principally for housing.

### **Insurance Conditions:**

Policy holder:	The principal.
Insured:	The principal and the following owners of the building in whole or in part.
Premium payment:	The premium should be paid at the moment the work is finished.
Due date:	10 years, without possibility of cancellation.
Sum Insured	100 % for structural damages, on the final cost of the material execution of the construction, including the professional fees, licences and taxes.
Deductibles:	1 % of the risk values at the most.

The following concepts are excluded:

- Physical injuries or other economical damages different from the material damages guaranteed by Law.
- Damages to buildings adjoining or adjacent to the building.
- Damages caused by changes or other works carried out in the building once the certificate of acceptance has been issued, except for the works to repair the known defects.
- Damages caused by bad use or inappropriate maintenance of the building.
- Expenses for the maintenance of the building once the certificate of acceptance is issued.
- Damages caused by fire or explosion, provided there is no fault or defect to the installations of the building.
- Damages caused by accidental cause, force majeure, act by third parties or the person harmed by this damage.
- Claims due to parts of the construction about which some reserves are recorded in the act of acceptance, while they are repaired and the repair works are recorded in the new act of acceptance signed by the signers of the previous act of acceptance.

Before the effective date of the policy, the Insurer will have to receive the following documents from the Policy holder or the Insured:

- Final report issued by the Technical Control Body.
- Certificate of Acceptance
- Declaration about the find value of the insured goods.
- Total premium.

From the effective date of the policy, the Policy holder or the Insured should inform as soon as possible the Technical Control Body and the Insurer about all the circumstances that might aggravate the risk.

The Insurer will be allowed to cancel or modify the insurance policy within a time period of one month, from the day of the risk aggravation advice.

Additional coverage beyond the Law:

- Watertightness of the roofs
- Watertightness of the walls
- Watertightness of the basement
- Damages in previously existing buildings.
- Automatic adjustment revaluation of the insured sums and deductibles

**Technical Inspection Service (TIS):**

Company engaged by the Policy holder and agreed by the insurer. The fees and expenses of this Technical Control Body are charged to the Policy holder.

Tasks to be carried out by the TIS:

- Examination and control of the construction project, including its modifications.
- Control of the construction from the beginning, including possible modifications.
- Issue of the necessary technical reports.
- Presentation and signature at the commissioning date, with the indication of possible technical reserves.

Characteristics of the TIS:

- To have independence from the agents involved in the construction process (engineers, constructors, manufacturers, financing agents).
- Professional experience, as well as a sufficient technical and qualified team.
- Sufficient Professional Liability Insurance

### 3 ITALY

#### Merloni Memorandum

On the 27<sup>th</sup> July 2000 the so called Merloni Law became effective . This set of regulations applies to public contract works and introduces a number of very significant changes in the insurance requirements which include bonding , construction , decennial liability and designers' professional indemnity .

In the area of technological classes , it has become compulsory for contractors being awarded public works to stipulate certain insurance policies and namely :

- 1) **Construction All Risks** for the full contract value of the works including cover for loss and or damage to Principal's existing property ( loss limit not indicated ) ;
- 2) Cover against **General Third Party Liability** for a limit equal to 5% of contract value up to a maximum of EU 5,000,000 ;
- 3) **First Party Decennial Liability** Policy for a limit not lesser than 20% of contract value but not exceeding EU 14,000,000,
- 4) **Third Party Decennial Liability** Policy with a limit of not less than EU 4,000,000 .

The law states that insurance will not include loss and or damage caused by 1) "**Force Majeure**"

- 2) **Third parties**.

#### Comments on CAR

There is already evidence that , in the majority of instances , Principals will request that contractors insure on a wider basis than that compulsory by law and insurance conditions will tend to reflect those commonly used in the market ( i.e. without the above mentioned exclusions).

The policy wording recently submitted by A NIA to the Ministry in respect of CAR insurance, contains a clause whereby any **policy deductible** will be applicable to the Contractor only , the Principal being entitled to full indemnity . This may present insurers with a problem in the event of the contractor becoming insolvent during the course of construction and after the occurrence of insured losses . However it must be kept in mind that only certified contractors will be allowed to participate in public tenders . Besides , the very onerous **bonding** regime will entail insurers to investigate the financial soundness of contractors more carefully than in the past before giving cover.

#### Comments on Decennial Liability

The Ministry for Public Works have decided to set the limit above which decennial liability insurance becomes compulsory for public contracts at EUR 10,000,000 . This will result in only the larger projects being insured and therefore this section of the law producing a substantially lower premium income than anticipated .

The scope of the cover is " **named perils** " , **property type** ( first party ) modelled on the contents of art. 1669 of the italian civil code which is in respect of **structural components** of civil works constructed for **long duration** . The policy wording submitted to the Ministry contains a more detailed qualification in that it refers only to " **partial and / or total collapse and important constructional defects suffered by component parts** of the works

**subjected to static testing in accordance with law 1086/1971** (subsequently modified as per final policy wording).

In essence it is a far more restricted cover than that commonly applied in the French market and reflecting the requirements of the **Spinetta Law** which extends to virtually all parts of constructions .

As regards **technical controls** , the National Insurance Association , through its technical committees, has started a project in cooperation with **UNI** ( standard of material and construction certification ) and **SINCERT** ( certification of technical controllers ) with a view to establishing procedures and standards of control in respect of different categories of works ( by size , nature , complexity , materials used , construction processes etc . ) . For simple and low-valued projects , technical controls will be limited to those effected by the Principal to comply with its administrative obligations , insurers being entitled to examine the contents of the certificates issued by the appointed controllers .

As regards the private sector , demand for decennial liability insurance is growing in the wake of the introduction of the Merloni law as Principals tend to regard the stipulation of this cover as an additional guarantee against the risk of having to repair or replace defective structures failing to recover from the responsible party as a result of insolvency or pending long-drawn-out litigations.

A NIA 's (NATIONAL ASSOCIATION OF INSURERS) projections indicate an **annual premium volume** of approximately **EU 250,000,000** generated by the introduction of Merloni Law for all classes of insurance ( bonding , CAR , decennial liability ) .

It can be expected that the requirements of the Law will gradually be translated into contracts between private parties so creating a strong link between construction and decennial liability insurance .

Due to the lack of previous experience in the market , it is difficult to forecast technical results for decennial liability insurance as the number of unknown factors ( prevailing levels of rating , volume of business , effective application of technical controls , composition of the portfolio etc . ) is very great . Professional reinsurers with established experience of this class in other markets ( particularly Swiss Re and Munich Re ) tend to believe that , given the known starting conditions , the experience should be sustainable in the long term.

Some additional aspects worth mentioning and namely :

The **policy wording** has been approved by the competent Ministry ( Public Works) after extensive consultation with the National association of Insurers (ANIA) .

1. Cover attaches upon issuance of the Provisional Acceptance Certificate ;
2. The policy is stipulated by the executor of the project for the benefit of the Principal ;
3. Technical control will make sure that contract works have been realized in compliance with the standards of UNI CEI ISO 45000 ( a condition of liability under the policy ) ;
4. Grave constructional defects are defined as those which affect parts of the project intended for long duration and effectively endangering the stability or safe access to the property declared by the competent Authority ;
5. The subject matter of the cover is limited to structural components of the project constructed for long duration and apt , by their nature , to stand static and dynamic stress ;
6. Non structural components , such as waterproofing , finishings , thermic and acoustic insulations , technological plants and the like , are not included in the cover .

### Scope of the Cover

The policy covers loss and or damage to the subject matter insured (complete project) for a period of 10 years from the date of provisional acceptance , caused by:

1. total and/or partial collapse of the project;
  2. important constructional defects affecting structural components intended for long duration ,
- providing such loss and/or damage is a consequence of a constructional defect or an error in the executive plan/design.

### **Standard Exclusions**

1. defects known before the attachment of the policy ;
2. loss and/or damage consequent upon modifications carried out after the date of provisional acceptance causing physical alterations to the structures ;
3. fire , lightning , explosion , collapse , electrical phenomenon unless caused by structural latent defects as defined above ;
4. "force majeure"
5. defective and/or insufficient maintenance ;
6. gross negligence of the insured , the user or the persons for whom they are responsible ;
7. expenses incurred to identify the loss , unless specifically insured against ;
8. loss resulting from overloading or the application of conditions beyond the project's tolerance.

### **Technical Framework**

The application of the new rules for decennial liability attaching to the construction of public works is set within a framework of technical controls and requirements which involve the **certification of general contractors** by specially appointed technical bodies (SOA) in relation to the size and complexity of the **projects** to be executed , the analysis of design , materials and construction methods to insure compliance with the required standards carried out by **licensed technical controllers , periodic checks during** construction , and the **participation of insurers** in the process to apply appropriate levels of control and mitigation of exposure during the insurance period .

## 4 FINLAND

Housing transaction act – 1998

In Finland, there is an obligation to insure the decennial liability. The beneficiary of this insurance is the owner. It is a liability for 10 years. First of all this insurance is an insurance for insolvency but optionally the policy can cover inherent defect without insolvency. The main difficulty met by the market is the insufficient quality control during building.

This insurance is compulsory for the principals. This is a third party insurance.

The insurable projects are houses. The buildings sites are reviewed by a controller from the insurance company.

## 5 AUSTRALIA – Victoria

Building act 1993 K- N° 126 of 1993

In this Australian state, there is an obligation of insurance for decennial liability.

Art 135 – Order requiring insurance

1. The Minister may, by order published in the Government Gazette :
  - a) require building practitioners in specified classes of building to be covered by professional indemnity insurance, a performance bond or other liability insurance or insurance scheme  
and :
  - b) specify the kinds and amount of insurance by which building practitioners in each specified class are required to be covered.
3. An order under sub-section (1) must state the date of taking effect of the order which must not be earlier than one month after the date of publication of the order in the Government Gazette
4. The Minister may revoke an order made under sub-section (1)
5. The Minister may consult with the Building practitioners Board before making an order under this section.

## 6 CANADA – British Columbia

Home owner protection act

Developers and contractors must write a policy for their liability.

A person must not build, offer for sale or sell a new home unless the new home is covered by home warranty insurance provided by a warranty provider.

Home warranty insurance for a new home must provide coverage for :

- A) Defects in materials and labour for a period of at least 2 years after the date on which the warranty begins
- B) Defects in the building envelope, including defects resulting in water penetration, for a period of at least 5 years after the date on which the warranty begins, and
- C) Structural defects for a period of at least 10 years after the date on which the warranty begins

If required by the regulations, a person must not undertake a renovation or offer for sale or sell a renovated home unless the renovation is covered by home warranty insurance provided by a warranty provider.

## 7 USA - New Jersey

New home warranty and builder's registration act.  
Chapter 25 July 1st, 1979

This compulsory insurance covers the liability of developers and contractors regarding the individual homes.

### **Registration required**

No individual, partnership, corporation or other business entity shall engage in the business of constructing new homes unless registered with the Departement in accordance with this subchapter.

### **Enrollment in a warranty plan**

Each builder or building business entity shall, at the time of registration, indicate on the registration form the warranty plan in which that entity is enrolled or chooses to be enrolled. No builder or building business entity shall be issued a certificate of registration unless they have enrolled or have applied for enrollment in either the State Warranty Plan or a private warranty plan.

### **Warranty coverage**

The warranty made applicable by these regulations shall be as follows :

- 1) One year warranty : for a period of one year from the warranty date each new home shall be free from :
  - performance standard defects
  - appliance fixture and equipment defects
  - mechanical and electrical systems defects
  - major structural defects
- 2) Two year warranty : for a period of two years from the warranty date each new home shall be free from :
  - appliance, fixture and equipment defects only if such defects are covered under a manufacturer's warranty  
NOTE : No warranty for appliances, fixtures or equipment shall exceed the length and scope of a warranty offered by the manufacturer.
  - Mechanical and electrical system defects
  - Major structural defects
- 3) Ten Year warranty : for a period of 10 years from the warranty date each new home shall be free from :
  - major structural defects

### **Builder responsibilities**

Each builder shall be responsible for the correction of any defect which appears during any of the warranty period specified in this section, unless such responsibility is otherwise assumed by a private plan of which he is member. Participant to the State Plan shall be responsible for correction of defects for the first two years of the warranty.

The builder's responsibility in the case of a defect covered by this warranty shall include removal of the defects by repair or replacement or payment of the reasonable cost of repair or

replacement. The builder's responsibility shall include actual reasonable shelter expenses during repair.

## **8 OTHER COUNTRIES**

### **ALGERIA**

Art. 554 Civil Code 1975

The architect and the contractor are jointly liable for 10 years for any total or partial destruction even in case of ground default.

This liability is extended to inherent defect within the structure of the building.

### **SAUDI ARABIA**

Royal Decree n° M/14, date 7/04/1997

Art. n° 121

The contractor shall stand answerable for a period of ten years, for any collapse, whether total or partial, that may occur as a result of defective execution, in the buildings or other permanent structures erected by him, unless it is contemplated in the contract that such buildings and structures shall serve for a period of less than ten years. The guarantee hereunder shall cover such defects as may appear in the buildings and structures and threaten the strength and safety of the construction.

The ten-year period referred to shall start to run as of the time of delivery of the work. However, if any collapse occurs or any defect is discovered and the soliciting agency fails to invoke the guarantee within a year from such occurrence of discovery, it shall forfeit its right to institute any action against the contractor in this respect.

### **GABON**

Decree N° 62 from Insurance National Department

Art 1

This article says that all state works have to be insured. The coverage includes the cover « unfit for its intended purpose ».

Art 2

This is a decennial cover with a 2 years cover for equipments.

Art 3

The Technical Inspection Company is insured in the same policy.

### **CAMEROON**

Art. 1792 – 2270 Civil Code

Similar to ALGERIA

### **CONGO – BRAZZAVILLE**

Act n° 77/318 dated 17/08/77

Similar to ALGERIA

### **MALI**

Act n° 79-27/CNLN

Similar to ALGERIA but just for the contractor (not the architect)

### **MOROCCO**

Art 769 modified (Dahin dated 9 ramadan 1331) Civil Code

Similar to ALGERIA but also for the engineers.

### **CENTRAFRICA**

Act n° 83 053 dated 02/08/83 and decree n° 84.129

Similar to MOROCCO

## **TUNISIA**

Art 1 – Law n° 94 – 9 dated 31/01/94

This law applied to architects, contractors, engineers, controlers, developers for 10 years.

## II - COUNTRIES WITH LEGAL BUILDER'S LIABILITY, WITHOUT COMPULSORY DECENNIAL INSURANCE BUT WITH INHERENT DEFECT INSURANCE MARKET

### 1 BELGIUM

Insurance of the architects and contractors liability with technical control – « Insurance – Control ».

#### GOAL

The goal of this insurance is to cover

- the liability of all builders participating in the erection of a project including the decennial liability towards the owner.
- Damages to the project in course of erection consequence of its collapse or important defects that could lead to its destability.

#### COVERS

- During the construction
  - A1 → Damages consequences of a collapse or threat of collapse
  - A2 → Constructors liability to the owners or other third party due to the building works
    - Owner's liability towards third party due to the buildings works
- After the commissioning
  - B1 → decennial contractors liability
  - B2 → Contractors and owner's liability to the reprations made in case of loss paid in B1
  - B3 → B1 extension to existing property before erection of the new project and non material Damage

#### PARTICULARITIES

- Compulsory control made by SECO
- All builders are insured
- It a policy for a single project
- The cover is maintained for 10 years even if one contractor should go bankrupt

#### BELGIAN STATISTICS

Number of claims :	Structural works	30 %	
	Roof structures		15 %
Type of claims :	Humidity	22 %	
	Surface alteration	20 %	
Origins of claims :	Design :	30 %	
	Workmanship :		23 %
	Material :	23 %	

The Belgian market represents around MM US\$ 0.5

## 2 UNITED ARAB EMIRATES

Federal law N° 5 dated 1985 – Art. 880

- 1) If the tender's agreement is to construct buildings or other immovable constructions designed by a consultant engineer and executed by a contractor under his direct supervision, they shall be jointly liable to compensate the tender's beneficiary throughout a ten year period for any total or partial destruction to any of the buildings being constructed or any construction being erected and for any defect endangering the safety and firmness of the building if the contract does not otherwise include a longer period, and this shall all continue unless both parties desire that such constructions shall remain be for a period of less than ten years.
- 2) The liability to assume the asserted compensation shall remain even if the law would result from a defective condition in the land itself or if the tender's beneficiary has agreed to construct the defective buildings or constructions.
- 3) The ten years period shall start from the date of completion of work.

### 3 JAPAN

Art 533, 634 and 638 Civil Code

House quality and warranty law (dated 23/06/99)

One of the parties to a bilateral contract may refuse performance of his own obligation until the other party tenders performance of his obligation ; however, this shall not apply where the obligation of the party is not due.

If any defect exists in the subject-matter of the work the person who ordered the work may fix a reasonable period and demand from the contractor the rectification of such defect ; however, this shall not apply if the defect is not material and its rectification would involve excessive expense.

The person who has ordered the work may demand compensation for damages in lieu of or together with rectification of the defect ; in such cases the provisions of Article 533 shall apply mutatis mutandis.

A contractor for a structure to be erected on land is liable for warranty in respect of any defect in the structure or in its foundations for a period of five years after delivery ; however, this period shall be ten years in the case of a structure made of stone, earth, brick or metal.

If the structure is destroyed or damaged by reason of a defect as mentioned in the preceding paragraph, the person who ordered the work shall exercise the rights mentioned in Article 634 within one year from the time of such destruction or damage.

The house quality and warranty law has been voted at the Diet on the 23th of June 1999 and is in course from 1<sup>st</sup> of april 2000. This law, which modifies the contractors and sellers liability in the residential sector, contains three points :

- 1) a ten year liability for contractors and sellers. This liability is for defects in structural elements of houses plus in elements that can protect houses against rain.
- 2) Implementation of new standards of houses construction
- 3) Rating of the houses made by inspection companies agreed by the state to measure the quality (earthquake, sound, fire). The rating is not compulsory.

## 4 KUWAIT

Art.692 to 697 Civil Code n° 67 of 1980

### Art . 692

- 1) Both the Contractor and the Architect shall guarantee any total or partial collapse or failure of the buildings and fixed installations which they have constructed for ten years as from the date of completion of such building or construction, subject to the following Articles.
- 2) Nevertheless, if it is established that the contracting parties intend for the buildings or installations to last for a period of less than ten years, the guarantee shall be extended for this period only.
- 3) The guarantee shall include the collapse even if it results from a defect in the ground involved or if the Employer has permitted the construction of the defective buildings and installations. It shall also include any defect that may appear in the buildings and installations resulting in a threat to their consistency and safety.

### Art . 693

- 1) Where the work of the Architect is limited to drawing up the design of the building or construction or part thereof, he shall be responsible for such defects as are attributed to the design he drew up, excluding defects in the method of execution.
- 2) If the employer entrusted the Architect with supervision of all or part of the execution, he shall also be responsible for defects pertaining to the method of such execution.

### Art. 694

- 1) The contractor shall be responsible only for such defects as may occur in the execution other than the defects which arise out of error in the drawing up of the design unless these defects are visible.
- 2) Nevertheless, the Contractor shall be responsible for defects which are attributed to the design if the Architect who drew up the design is engaged by him.

### Art. 695

If the event of the Architect and the Contractor both being held responsible for any defect which occurs to the work, they shall be jointly and separately responsible for such defect.

### Art. 696

The case of warranty against the Architect of the Contractor shall stop with the lapse of three years as from the date on which the collapse occurred or the defect was discovered.

### Art. 697

Any condition relieving the Architect or the Contractor from the warranty or limiting it shall be null and void.

## **5    SENEGAL**

Art 449 to 451 of the Commercial and Civil Code.

### **III – COUNTRIES WITH LEGAL BUILDER’S LIABILITY AND WITHOUT COMPULSORY DECENNIAL INSURANCE AND WITHOUT INHERENT DEFECT INSURANCE MARKET**

#### **1 ARGENTINA**

Art. 1646 – Law 1771

In the case of buildings or works on real estate intended for long-term duration, received by the contracting party, the constructor is liable for total or partial destruction if same originates from faulty construction, faultiness of the soil or bad quality of the materials used, whether or not same were provided by the constructor or the work affected on land owned by the tenant.

For liability to be applicable, destruction must occur within ten years after delivery of the contracted work and the prescription period for legal action will be one year after same took place.

The liability imposed by this paragraph will be applicable to include indistinctly the work superintendent and the designer, according to the circumstances, without prejudice to a possible recourse against whom it may concern.

A contracted annulment of liability due to total or partial destruction is inadmissible.

## 2 CANADA - QUEBEC

Fifth book, chapter 8, Section II, paragraph 2 – Civil Code

A client who accepts without reservation retains his right to pursue his remedies against the contractor in cases of non apparent defects or non apparent poor workmanship.

Unless they can be relieved from liability, the contractor, the architect and the engineer who, as the case may be, directed or supervised the work, and the subcontractor with respect to work performed by him, are solidarily liable for the loss of the work occurring within five years after the work was completed, whether the loss results from faulty design, construction or production of the work, or the unfavourable nature of the ground.

The architect or the engineer may be relieved from liability only by proving that the defects in the work or in the part of it completed do not result from any erroneous or faulty expert opinion or plan he may have submitted or from any failure to direct or supervise the work.

The contractor may be relieved from liability only by proving that the defects result from an erroneous or faulty expert opinion or plan of the architect or engineer selected by the client. The subcontractor may be relieved from liability only by proving that the defects result from decisions made by the contractor or from the expert opinions or plans furnished by the architect or engineer.

They may, in addition, be relieved from liability by proving that the defects result from decisions imposed by the client in selecting the land or materials, or the subcontractors, experts, or construction methods.

The contractors, the architect and the engineer, in respect of work they directed or supervised, and, where applicable, the subcontractor, in respect of work he performed, are solidarily liable to warrant the work for one year against poor workmanship existing at the time of acceptance or discovered within one year after acceptance.

An architect or an engineer who does not direct or supervise work is liable only for the loss occasioned by a defect or error in the plans or in the expert opinions furnished by him.

For the purposes of this chapter, the promoter who sells the work which he has built or caused to be built, even after its completion, is deemed to be a contractor.

### **3 NETHERLANDS**

Art. 1645 Civil Code

If any building, build under contract for a certain price, complete by any defect in the structure or event due to unfitness of the underground, the architect and contractors are therefore responsible for ten years.

## 4 IRAQ

Art. 870 law n° 40 dated 1951 modified by law n° 48 dated 1973

- 1) architects and contractors shall guarantee, during a ten years period, partial or total collapse of buildings or constructions they established even if such collapse is due to defect in the soil, even if the principal licensed such defective constructions, unless the contracting parties had intended such constructions to survive for a period less than ten years. The ten years period starts from the time of completion and delivery of works. Every condition which meant to exempt from or limit such damage is considered void.
- 2) The above terms apply to all contracts which have been in force before they came into force, but not to the contracts the guarantee period of which had terminated before those terms came into force.
- 3) The guarantee stipulated in article (1) above applies also to the inherent defects in the building and the constructions which may weaken the building safety.
- 4) The right to bring legal proceedings for liability in accordance with the above article shall be limited to one year from the date of collapse or discovery of defects.

## 5 JORDAN

Art. 788 to 790 Civil Code ;

If the construction contract stipulated that the Architect design and supervise construction while the contractor undertook construction, they will be jointly liable for any damage that occurs to any building or part thereof and for any threat to public safety caused by such building (s) or part thereof for a period of ten years

The obligation to compensate will apply even if the threat/damage resulted from a fault in the land itself.

The 10 years period shall start from the date of delivery of the works.

If the Architects work was restricted to design without supervision his responsibility would be restricted to the flaws in the design and should the contractor be responsible only for a construction his responsibility would be restricted for that part of the contract only.

Any condition or stipulation to the effect of relieving the contractor or an architect of the above responsibility is declared null and void.

## 6 PHILIPPINES

Art. 1723 Civil Code

The engineer or architect who drew up the plans and specifications for a building is liable for damages if within **fifteen years** from the completion of the structure, the same should collapse by reason or a defect in those plans and specifications, or due to the defects in the ground. The contractor is likewise responsible for the damages if the edifice falls, within the same period, on account of defects in the construction or the use of material or inferior quality furnished by him, or due to any violation of the terms of the contract. If the engineer or architect supervises the construction, he shall be equally liable with the contractor.

Acceptance of the building, after completion, does not imply waiver of any of the causes of action by reason of any defect mentioned in the preceding paragraph.

The action must be brought within ten years following the collapse of the building.

## **IV - HOW TO UNDERWRITE INHERENT DEFECT INSURANCE**

The new underwriters' main responsibility is to understand the factors which influence the design and construction process and eventually lead to a building which is free of latent defects or otherwise. It soon becomes apparent that the key factors in running a profitable account are good risk selection and adequate technical audits. Experience has shown that these were sound principles and those insurers who adhered to them have paid out on few claims or, indeed, none at all. Those underwriters who chose to write business indiscriminately or to diminish the role of technical auditors have suffered some significant losses.

Many of the ills of that industry would be resolved if broader forms of latent defects cover were to emerge at prices which were attractive to buyers. This belief, shared by others, gave rise to a further responsibility i.e. the need to underwrite the latent defects account properly and profitably. There is enough evidence to suggest, even taking into account the poor experience in France, that this day arrived some time ago. So far the wider covers have not emerged and the level of protection available remains virtually unchanged from ten years ago although underwriting attitudes have become more flexible. Those who have purchased the policies have no reason to be dissatisfied with the product provided any losses have been paid promptly. There is evidence that some of those insured that have not had losses may owe something to the scope of the technical audits.

The provision of such covers is a difficult area for insurers. There has never really been any consensus among underwriters as to whether these are best dealt with by long-term policies or as an extension to annual engineering policies. It is also not easy to decide how far engineering cover should extend. Should policies restrict cover to Damage and the avoidance of imminent Damage caused by inherent defects?. Should insurers be willing to accept liability when plant equipment and services do not conform to the agreed specification? Could they accept liability for failure to meet specified performance standards? Do they accept liability for any shortcoming in the original specification?

So far most of the engineering covers made available have limited protection to actual Damage as defined caused by an inherent defect or such cover plus the cost of avoiding imminent Damage. As annual Engineering policies already pay many claims where the cause is an inherent defect it is not always clear to potential buyers what the real value of the extra cover is.

Will the insurance industry rise to the occasion? Will they find the right products and services at a price that will enable them to encourage developers to part with an appropriate premium?

### **1- INHERENT DEFECTS INSURANCE POLICY**

Inherent Defects Insurance Policy ( **IDI** ), is answering this need. It covers PHYSICAL DAMAGE TO A BUILDING caused by faulty design, faulty workmanship and/or faulty materials in the structural works (load-bearing elements essential to the strength and stability of the building, as well as works forming part of external walls and roofing) that were not evident at the date of inception (which may be defined as the completion of work), running for a period of ten years after acceptance. The single premium is payable before this date and therefore, THIS POLICY CANNOT BE CANCELLED even after a loss occurs by the insurer.

As mentioned above, a construction project, like any other creative activity, is always subject to minor faults. This is why the IDI policy includes A DEDUCTIBLE to eliminate claims for such defects, which are in no way unusual. By restricting cover to major structural damage, which has

the greatest impact on the insured but which is the least often encountered, the excess keeps the insurance cost down to an acceptable level.

As IDI covers not only identical replacement of the defective structure but also reconstruction in such a way that the building, once repaired, will be durable, it can only be taken out provided the design and construction of the building have been checked by a technical consultant approved by the insurer : Technical Inspection Service ( **TIS** ).

IDI is a first party policy, which means that normally only the principal (and/or the financiers of the project) can be the insured. Nevertheless, contractors can also be protected by waiving the right of subrogation against them.

When a claim is made, the insurer appoints an adjuster whose first task is to check whether the conditions of the cover have been met. If so, REPAIR WORK CAN START WITHOUT WAITING FOR ESTABLISHING THE BUILDERS' LIABILITY. The adjuster may then be asked to establish liability so that he insurer can take legal action if he thinks it is opportune.

## **2- TECHNICAL INSPECTION SERVICE**

As indicated previously, IDI covers not only identical replacement of the defective structure but also reconstruction in such a way that the building, once repaired, will be durable.

Such defects result from errors which form part of the normal risk of construction companies or which can be due to savings required by the Insured, and it is important tht they do not act as though their insurance cover releases them from their responsibility. Therefore an independent inspection is required by the Insurer. This is the role of the Technical Inspection Service (TIS).

The purpose of the Technical Inspection Service, whose appointment must be approved by the Insurer, is to advise the insurer of the level of quality of the construction, i.e. that it has been built according to proper and relevant standards, using appropriate materials and taking due care.

The TIS is required to give impartial technical advice. Therefore it must be independent of the owner, the construction companies, the architect and the design office. Accordingly, it must not participate in the design and construction of the building, nor in the management and supervision of the site. In addition, the TIS should not act as a loss adjuster, in case of damage, on a building it has checked.

Based on the coverage offered by IDI, the activity of the TIS applies in the following areas :

- The design (calculation hypotheses, specifications, drawings)
- The materials (specifications, test certificates, implementation methodes)
- The work on the site

As there is a presumption of honesty and skill (which needs to be checked by the TIS) of the different parties, the TIS should not be obliged to be permanently on the site. Consequently its engineers normally proceed with selective controls, are not involved in the site management and therefore are able to pass impartial judgement on the works.

The TIS should rely on its own professional experience to pin –point the key elements to be checked and the timing at which it will be necessary to carry out spot inspections to be sure that the construction works are properly performed.

At the beginning of the project, the TIS will carry out a preliminary review of the specifications of the project, and all other pertinent documents which it needs to issue the Risk Appraisal Report. This report has to describe the structure to be built, the materials and the type of foundation to be used and the difficult or potentially trouble some points. It has also to include any technical reservations that the TIS has regarding the inadequacy of the design of the suitability of the building. The intent of the preliminary review is to allow the Insurer to determine whether the premises can be considered for coverage under the IDI policy, as well as to help him rate the risk.

The design review is the logical follow up to the preliminary review. The TIS will check for compliance with all applicable codes, practices and professional standards (as well as drawings, specifications, reports). Special attention needs to be given to the adequacy of the foundations taking into account the soil conditions. This can be determined by reference to the soil report. If any discrepancy is found that might change the nature of the risk, the TIS has to notify it to the Insurer and has to contact the Insured in order to solve the problem in due time. If the discrepancies cannot be resolved, the TIS has to notify the insurer and the Insured of any possible reservations.

During the construction, the TIS has to monitor the implementation of the works, by spot inspection, the number of which should be based on TIS experience. The TIS may attend site meetings at its own convenience and should report project progress to the Insurer.

The TIS should make sure that the approved drawings are followed by the constructor and that approved materials are correctly used. The TIS should review all on-site testing reports and should check that the tests have been properly performed by qualified people.

The TIS will recommend any additional tests it estimates to be necessary. In addition, the TIS should indicate to the Insurer any modification that leads to a new evaluation of the risk.

At the end of the construction, the TIS after having checked the as-built drawings, issues a Certificate of Approval including the reservations which have not been resolved. This certificate is an integral part of the IDI policy. If there is no modification of the risk with respect to the Risk Appraisal Report and no unresolved reservations, then the Insurer can confirm its commitment on the risk.

### **3- WHAT KIND OF CONSTRUCTION CAN BE INSURED ?**

It seems illusive to wish to cover all types of construction with IDI. It is clear that the works which are either temporary or the life period of which is short (less than 4 years) are not eligible for such insurance. For these constructions, the cost of which is generally not high, the owners can be protected through existing policies such as PI insurance (the probability that the chosen contractor gets bankrupt during this limited period is small) or CAR maintenance endorsement. With others constructions, the life duration is higher, cannot also be insured by IDI because either they need an annual maintenance program to be maintained in such a condition they can be used (marine works for example), or because their everlastingness is mainly due to the way they are used and not only how they are built (silos for example).

In conclusion, to be eligible for IDI coverage, construction should, at least, meet the following requirements :

- Life period over 4 years
- Everlastingness not depending on maintenance program or use
- Control cost (TIS fees) not excessive in comparison with the total construction cost

#### **4- UNITED KINGDOM**

The UK market - Present market developments

The following comments apply to commercial buildings and exclude domestic housing, where a guarantee is given on same under a scheme operated by the NHBC.

IDI is not as widely purchased in the UK mainly because the developers believe the cost is too high compared to the risks that are being transferred to the IDI insurance policy, particularly as the TIS provides an additional view that a development has been constructed properly. Developers are now requesting that insurers consider:

- Providing cover for 12 years to reflect liability for contracts under seal
- Providing cover for projects that have been constructed and completed without independent TIS. Such risks have been considered following a design check and survey and at additional premium consideration
- Reducing cost as there have been few IDI claims
- Paying premium on an annual basis over the period of the policy
- Avoiding duplication of dual TIS with use of developers own design information or other local authority design review and checking requirements
- Reducing excesses from present levels
- Consider broadening cover to include non-structural elements and cover for mechanical and electrical.

Some of this drive has come from lenders in Private Finance Initiative developments where Concessions companies operate the business for 30 years so are looking to transfer some of their risks to insurance providers including Inherent Defects risks. Insurers are considering how they can rise to these challenges.

The complexity of modern constructions means there is an appreciable risk of defect occurrence. When damage affects the structural parts, the owners may have to face important financial implications. To guard against this hazard he has now the possibility to buy Inherent Defects Insurance, a non cancellable first party policy running up to 10 years after the completion of the works.

Although the policy general conditions requires technical check of the design and the works, which can marginally increase the construction cost, it enables owners to contemplate the future of their asset with serenity, because they are sure to be able to face any major damage that can occur.

## CONCLUSION

This paper has showed some aspects of this quite new line of business in the engineering insurance field.

Inherent Defect Insurance for construction is mostly developed in France. This country has developed a specific experience due to the strict regulations from the Spinetta Law.

Nevertheless, a lot of countries in the world have set precise liabilities for builders in order to protect the principals.

Generally, this liability is a 10 years liability.

We have seen that only a few of these countries oblige builders to take an insurance policy.

Most of the others prefer to let them free with this liability.

That is really an opportunity for engineering insurance companies to enter this new market, on a first party policy basis.

Of course, there are some risks to avoid and the french example proves that it is not easy. All insurers have lost a lot of money in the last decade because they have underestimated the claims that have occurred.

Nevertheless, we have shown that there is a way to make this business profitable. First of all, the cover has to be well defined. Then deductibles must apply. Finally, a Technical Inspection Service must be put in place with agreed companies. The Technical Inspection Service will be facilitated if there are satisfying local technical standards for construction design and materials.

These three minimum requirements can make this market profitable.

The potential of premiums for this line of business can be estimated at around 0,125 % of non life insurance premiums country.

This development of this business needs the support of large reinsurers that have acquired some experience from countries in which there is already a market.

Insurance industry can help the building sector to set up quality labels : a building insured will be considered as a factor of quality. Insurers have to discuss this matter with their building and civil works companies insureds.

Insurance industry can participate in the securitization of financed projects.  
Insurance industry can value the construction for principals when the buildings has to be sold.

This paper gives a short description of what it is possible country by country.

Insurance companies and engineering underwriters have now possibilities to dig up this matter and to build up profitable portfolios.

## ADDENDUM

SAMPLE

INHERENT

DEFECT

INSURANCE

POLICY

# INHERENT DEFECT INSURANCE POLICY

## INFORMATION

This Policy has been prepared in accordance with your instructions. Please read it carefully to ensure that it meets with your requirements.

This Policy consists of the following sections:-

1. **PREAMBLE** - confirming that the insurance is in force
2. **DEFINITIONS** - defining terms used in the Policy
3. **INSURING AGREEMENT** - giving details of the cover under the Policy subject to any variation which may be made by endorsement
4. **POLICY EXCLUSIONS** - detailing exclusions which apply to the Policy
5. **POLICY CONDITIONS / PROVISIONS** - describing duties, obligations and procedures of the insurance
6. **SCHEDULE** - describing who and what is insured
7. **ENDORSEMENTS** - detailing alterations to the basic cover if any, agreed by the Insurers
8. **CERTIFICATE(S) OF APPROVAL** - as issued by the appointed Technical Inspection Service

## SPECIAL NOTE

Subject to certain conditions this Policy is capable of being transferred to subsequent owners of the Premises insured whose interest should be made known to the Insurers prior to such transfer in order to ensure that any change of use or occupancy of the Premises does not invalidate this Insurance.

**SECTION 1  
PREAMBLE**

In consideration of the Insured having paid the premium to the Insurers, the Insurers agree to provide insurance subject to the terms, conditions and exclusions of this Policy up to the amounts detailed in the Schedule, as Total Sums Insured during the Period of Insurance.

This Policy and its Schedule, Endorsements and the Certificate of Approval shall be read together as one contract and any word or expression to which a specific meaning or definition has been given shall have such specific meaning wherever it may appear.

For and on behalf of Insurers:

Signed .....

Policy Number .....

Date .....

## SECTION 2 DEFINITIONS

For the purposes of this Policy, the following definitions shall apply:

- 1. Insured** The party or parties named in the Schedule, their successors in title and their assigns (subject to Insurers agreement in writing) together with such other parties described in the Schedule, to the extent of their respective rights and interests in the Premises stated in the Schedule.
- 2. Inherent Defect** Any defect in the Structural Works notified to the Insurers during the Period of Insurance which is attributable to a defect in design or workmanship or materials which was undiscovered at the date of issue of the Certificate of Practical completion.

- 3. The Premises** The whole and each and every part of the Works at the address stated in the

Schedule and the subject of:

- the Certificate of Practical Completion; and
- the Certificate of Approval issued by the Technical Inspection Service attached to and forming an integral part of this Policy:-

comprising:

(a) Structural Works

- (i) All internal and external load-bearing structures essential to the stability or strength of the Premises including but not limited to foundations, columns, walls, floors, beams; and
- (ii) All other works forming part of external walls and roofing of the Premises but excluding moveable elements of external windows, doors, skylights and the Non-Structural Works, Equipment, Fixtures and Fittings described below:-

(b) Non-Structural Works, Equipment, Fixtures and Fittings

All non-load bearing parts of the Premises other than those works described in paragraph 3(a) (ii) above as Structural Works including but not limited to electrical wiring and connections, equipment and fixtures for the collection and distribution of gas, water, heating and ventilation, partitions, internal windows, plaster, tiling, floor coverings, doors, surface finishing, drains, all fixtures and fittings and all permanent mechanical and electrical apparatus including boilers and similar plant included in the Building Contract irrespective of whether such non-load bearing parts, equipment, fixtures and fittings are fixed to or incorporated in any part of the Structural Works.

(c) External Works

All external non-structural works owned by the Insured and the subject of the Building Contract, including but not limited to pavement, cross-overs, paved areas, pedestrian and vehicular, landscaping and all external drains, sewers, pipes, cables, wires and other service media.

- 4. Works** The works completed under the Building Contract
- 5. Finishing Operations** Any operation carried out for the purposes of completing and finishing the Premises after the issue of the Certificate of Practical Completion as provided for under the Building Contract.
- 6. Building Contract** The contract or contracts for the design and construction of the Premises.
- 7. Certificate of Practical Completion** The Certificate(s) of Practical Completion or other certificate confirming substantial completion of the Premises to be issued by the Insured's Architect, Engineer, Contract Administrator or other supervising officer under the Building Contract.
- 8. Date of Inception** The Date of Inception will be the date shown on the Certificate of Practical Completion issued by the Insured's Architect, Engineer, Contract administrator or supervising officer as the effective date of Practical Completion under the Building Contract.
- In those cases where the Building Contract provides for more than one Certificate of Practical Completion:
- (a) inception shall take place in respect of Premises which consist of a single building upon the issue of the Certificate of Practical Completion for the Premises as a whole unless otherwise agreed in writing by the Insurers; and
- (b) inception shall take place in respect of Premises which consist of more than one building upon the issue of the Certificate of Practical Completion for each building unless otherwise agreed in writing by the Insurers.
- 9. Technical Inspection Service** The party or parties engaged by the Insurers at the expense of the Insured, to provide such examinations of plans, specifications, bills of quantities and other documentation in relation to the Works and such inspections of the Works as the Technical Inspection Service and Insurers shall require. The duties of the Technical Inspection Service are restricted to advising the Insurers on the relative level of insurance risk that they can expect under this Policy.
- 10. Certificate of Approval** The certificate(s) issued by the Technical Inspection Service to the Insurers at the same time as or following Practical Completion under the Building Contract forming an integral part of this Policy.

### SECTION 3 INSURING AGREEMENT

- 1. Operative Clause** The Insurers agree to indemnify the Insured against the cost of repairing, replacing and/or strengthening the Premises following and consequence upon an Inherent Defect discovered and notified to Insurers during the Period of Insurance and not excluded herein causing any of the following events:-
- (a) destruction of the Premises; or
  - (b) physical damage to the Premises; or
  - (c) the threat of imminent collapse to the Premises which requires immediate remedial measures for the prevention of an actual collapse within the Period of Insurance.
- 2. Additional Benefits** In addition to and consequent upon the above indemnity the Insurers will indemnify:-
- (a) the cost of demolishing the Premises and/or the removal of debris from the Premises reasonably incurred by the Insured in connection with the events (a), (b) or (c) described above up to the amount stated in the Schedule;
  - (b) the reasonable legal, professional or consultants' fees incurred by the Insured solely in connection with the events (a), (b) or (c) described above up to the amount stated in the Schedule. The Insurers will not be liable to the Insured for fees incurred for the purpose of preparing a claim under this Policy;
  - (c) the additional costs of repair or replacing and/or strengthening in connection with the events (a), (b) or (c) described above which arise out of alterations in design, use or application of improved material, improved or altered methods of working or construction incurred solely and specifically in compliance with or consequent upon any building or other regulations under or in pursuance of any Act of Parliament or with Bye-Laws of any Public or Local Authority. This does not include the costs of complying with such requirements if notice thereof has been served before the events (a),(b), or (c) described above are discovered or such costs which relate to undamaged or unaffected parts of the Premises.

- 3. Period of Insurance** The period commencing on the Date of Inception and expiring on midnight ten years thereafter unless otherwise agreed in writing by Insurers, provided that:-
- (a) the premiums due have been paid to Insurers;
  - (b) the Certificate of Practical completion has been issued in accordance with General Condition 1;
  - (c) Insurers have received the Certificate of Approval.
- 4. Total Sum Insured** The sum shown in the Schedule representing the full rebuilding costs of the Premises at the Date of Inception adjusted in accordance with General Condition 2 and General Provision 3.
- 5. Limit of Indemnity** The liability of the Insurers shall not exceed in respect of each item which appears in the Schedule the final Sum Insured shown in relation to that item in the Schedule or in the aggregate the Total Sum Insured or where applicable the Limit of Indemnity (whichever is the lower) shown in the Schedule for the Period of Insurance unless cover has been either increased or reinstated by endorsement and the appropriate additional premium paid to Insurers but excluding in respect of each and every claim the amount specified in the Schedule as the Deductible.

## SECTION 4 POLICY EXCLUSIONS

### 1. This Policy does not cover any destruction, damage or threat of imminent collapse caused by, arising from or consequent upon:-

- (a) any fault, defect, error or omission in the design, workmanship, or materials of the Non-Structural Works, Equipment, Fixtures and Fittings or of the External Works;
- (b) any structural alterations, repairs, modifications or additions to the Premises during the Period of Insurance unless the Insurers have been informed, the Policy endorsed, and any appropriate additional premium paid to the insurers;
- (c) inadequate maintenance or abnormal use of the Premises or the imposition of any load greater than that for which the structure of the Premises was designed or the use of the Premises for any purpose other than that for which they were intended and as stated in the Schedule;
- (d) the wilful acts or wilful omissions of the Insured;
- (e) fire, lightning, explosion, earthquake, storm, tempest, flood, frost, bursting or overflowing of water tanks, pipes or other apparatus, water discharged or leaking from an automatic sprinkler installation, pressure waves caused by aircraft or other aerial devices travelling at sonic or supersonic speeds or the impact of aircraft or other aerial devices or articles dropped or falling therefrom;
- (f) ionising radiation's or contamination by radioactivity from any nuclear waste or from the combustion of nuclear fuel or the radioactive toxic explosive or other hazardous properties of any explosive nuclear assembly or nuclear component thereof;
- (g) war, invasion, act of foreign enemy, hostilities (whether war be declared or not), civil war, revolution, rebellion, insurrection or military or usurped power, riot, civil commotion, confiscation or requisition by any government or public or local authority;
- (h) faulty or deficient weatherproofing in the Premises;
- (i) faulty or deficient weatherproofing in those parts of the Premises below ground level;
- (j) the failure by the Insured or their contractors or agents to carry out and complete the Finishing Operations;
- (k) any matter notified to the Insurers by the Technical Inspection Service and referred to as a reservation in the Certificate of Approval or recorded in the Certificate of Practical Completion unless subsequently rectified and approved in writing by the Insurers;
- (l) subsidence, heave or landslip unless due to an Inherent Defect;
- (m) defects which are the responsibility of the insured's professional advisors or Contractors whether within the terms of the Building Contract or otherwise identified and notified to the Insured before issue of the Certificate of Practical Completion unless subsequently rectified and approved in writing by the Insurers;

- (n) the failure or omission of the Insured to commence or substantially undertake the repair, replacement or strengthening of the Premises for which indemnity is provided under this Policy within a reasonable period of time or such other period of time as may be agreed in writing by the Insurers.

**2. Further, Insurers will not be liable for:-**

- (a) The amount shown in the Schedule as the Deductible being that part of the risk which remains at the Insured's own expense and the said amount will be applied to each and every claim after the application of all other terms and conditions of the Policy including Average and not to the aggregate of claims arising during the Period of insurance;
- (b) any change in colour, texture, opacity or discoloration or staining or superficial deterioration or marring of finishings or surface appearance or ageing processes;
- (c) any consequential or economic loss or damage of any kind or description whatsoever including but not limited to loss, costs damages, expenses or penalties as a result of delay;
- (d) the amount of any tax, duty, charge, rate or levy arising out of capital appreciation.

## SECTION 5 POLICY CONDITIONS/PROVISIONS

### GENERAL CONDITIONS

#### 1. Duties of the Insured      The Insured will:

- (a) Supply the Insurers with a copy of the Certificate of Practical Completion within one month of the date of issue.
- (b) At their own expense, or through tenants, take all reasonable precautions to prevent destruction, physical damage or threat of collapse to the Premises and shall comply with Building or other regulations under or framed in pursuance of any Act of Parliament or with Bye-Laws of any Public or Local Authority which relate to the Premises;
- (c) Not enter into or permit third parties who are within their control to enter into any agreement, lease or contract with any person or persons involved to any extent whether directly or indirectly in the design, supply of materials for or construction of the Premises which would limit, curtail, nullify or otherwise render void or ineffective the Insurers rights or entitlements to the extent of the insurance provided under this Policy;
- (d) Not exercise or seek to exercise any legal rights or remedies whether directly or indirectly against Insurers in respect of the acts or omissions of the Technical Inspection Service.

#### 2. Premium Payments

The premium due to Insurers hereon at the Date of Inception is that calculated on the provisional Total Sum Insured as stated in the Schedule less the deposit premiums paid to Insurers. Within 3 months of the Date of Inception (or such later date as may be agreed in writing by the Insurers), the Insured must submit to the Insurers, the final Total Sum Insured. Any additional premium due must be paid to the Insurers within 30 days of notification to the Insured of the amount due.

All additional premiums for modifications, alterations or extensions of the Policy must be paid to the Insurers within 30 days of notification to the Insured of the amount due.

#### 3. Fraudulent Acts

If any claim is fraudulent or if any fraudulent means or devices are used by the Insured or any person acting on behalf of the Insured and entitled to receive any part of the proceeds of insurance under this Policy in order to obtain any benefit under this Policy or if any damage is occasioned by the wilful act of or with the connivance of the Insured, all benefit under this Policy will be forfeited.

#### 4. Change in Risk

If any material change shall occur varying any of the circumstances disclosed to or known to the Insurers whether occurring before or after the date of this Policy which, had it been known to Insurers, would have influenced their acceptance of the risk or the premium at which they would have accepted it, the Insured shall immediately give notice to Insurers of such change with full particulars thereof and the Insurers shall have the right to vary the terms of the Policy.

**5. Misdescription, Error or Omission**

This Policy will be voidable in the event of misrepresentation, misdescription, error, omission or non-disclosure by the Insured with intention to defraud.

**6. Difference in Deductible**

No insurance may be contracted by the Insured to cover the amount or part of the amount of the Deductible stated in the Schedule without the prior agreement in writing of the Insurers.

## CLAIMS CONDITIONS

### 1. Claims Procedure

On discovery of destruction, damage or threat of collapse to the Premises or any other circumstance which may give rise to a claim under this Policy or the happening of any damage not insured under this Policy but which may threaten the stability of the Structural Works, the Insured will at their own expense:

- (a) give written notice to the Insurers as soon as possible;
- (b) take all reasonable precautions to prevent further or any damage;
- (c) within 60 days of such discovery submit in writing full details of the claim then available to the Insurers;
- (d) supply or to the extent this is not possible, assist in procuring all reports, certificates, plans, specifications, quantities information and assistance as may reasonably be required by the Insurers.

### 2. Basis of Claim Settlement

In respect of an Inherent Defect causing:-

- (a) destruction of or physical damage to the Premises, the basis of settlement of the claim shall be the cost of repairing the damage to the Premises or renewing, replacing and/or strengthening those parts of the Premises thereby directly affected to a condition substantially the same but not better than or more extensive than their condition when new except insofar as it is necessary to alter the condition of the Structural Works to relieve the effects of the Inherent Defect directly causing the said destruction or damage;
- (b) the threat of imminent collapse the basis of settlement of the claim shall be the costs necessarily incurred by way of remedial measures to prevent an actual collapse of the Premises within the Period of Insurance.

The cost of any temporary and/or provisional repairs will be met by the Insurers providing their consent has been granted in writing to such repairs and that these repairs either constitute part of the final repairs or reduce the risk of further damage to the Premises.

The cost of any other alteration, additions and/or improvements shall not be recoverable under this Policy except as provided for in Clause 2(c) of the Insuring Agreement.

- 3. Arbitration** If any difference shall arise as to the amount to be paid under this Policy (liability being otherwise admitted), such difference shall be referred to an Arbitrator to be appointed by the parties in accordance with the statutory provisions for the time being in force. Where any difference is by this Condition to be referred to Arbitration, the making of an award shall be a condition precedent to any right of action against the Insurers.
- 4. Other Insurances** The Insurers will not be liable for any claim under this Policy which is insured by any other policy in the name of the Insured or on behalf of the Insured except in respect of any excess beyond the amount that would have been payable under such policy or policies had this insurance not been effected.
- 5. Subrogation** Any claimant under this Policy will at the request and at the expense of the Insurers do and concur in doing and permit to be done all such acts and things as may be necessary or reasonably required by the Insurers for the purpose of enforcing any rights and remedies or of obtaining relief or indemnity from other parties to which the Insurers will be or would become entitled or subrogated upon its paying for or making good any destruction or physical damage or threat of imminent collapse under this Policy whether such acts and things will be or become necessary or required before or after indemnity is provided by the Insurers.
- 6. Reinstatement** The total Sum Insured is reduced by the amount of each and every claim in excess of the Deductible from the date of first notification of each and every claim to the Insurers.

The Insured has the option, subject to the agreement in writing of the Insurers, to reinstate the Total Sum Insured on payment of the appropriate additional premium.

## GENERAL PROVISIONS

- 1. Access to Premises**      The insured will allow their Insurers or their representatives access to the Premises at all reasonable times.
  
- 2. Average**      The Total Sum Insured stated in the Schedule of this Policy is hereby declared to be subject to Average.

If, at the date of discovery of an Inherent Defect, the full rebuilding costs of the Premises at the anniversary of the Date of Inception immediately preceding the discovery, is greater than the Total Sum Insured adjusted in accordance with General Provision 3 below, the Insured will only be entitled to recover such proportion of indemnifiable costs as the adjusted Total Sum Insured herein bears to the full rebuilding costs.

In those cases where there is more than one Total Sum Insured specified in the Schedule, each is hereby declared to be separately subject to Average.
  
- 3. Mid-Term Alteration**      The Insured may, from time to time request an increase in the Total Sum Insured stated in the Schedule by written application to the Insurers. If the increase is accepted, cover will commence upon payment to Insurers of such additional premium as they may require.

Before agreeing to such increase the Insurers have the right to request the Insured to arrange an examination of the Premises by the Technical Inspection Service at the expense of the Insured.
  
- 4. Assignment**      The Insured shall not assign this Policy without the prior consent in writing of the Insurers and at the same time as any permitted assignment, the Insured shall assign to the assignee of the Policy all its rights, title and interest in and to contracts in respect of the supply of materials for, design and construction of the Premises.
  
- 5. Governing Law and Jurisdiction**      It is hereby agreed that this Policy shall be governed by and construed in accordance with English Law and subject to Claims Condition 3 above, the English Courts shall have exclusive jurisdiction in any dispute arising hereunder.

**SECTION 6  
SCHEDULE**

**This Schedule forms part of and is incorporated in Policy Number :**

Insurers :

Insured :

Premises Insured :

Type of Premises :

Period of Insurance :

Date of Proposal :

**Sums Insured / Limit of Indemnity**

Item 1. Structural Works : As per Proposal Form

Item 2. Non-Structural Works : As per Proposal Form

Item 3. External Works : As per Proposal Form

Item 4. Removal of Debris : As per Proposal Form

Item 5. Professional Fees : As per Proposal Form

**TOTAL SUMS INSURED :**

**Limit of Indemnity :**

**Deductible :**

**Total Premium : \*\*\*\*\***

**Endorsements Applicable at Date of Inception**                      **Number**    **Type**  
(see Endorsement Wording for details)

**SECTION 7  
ENDORSEMENT****FULL INDEXATION - 04**

Where the Insured has elected and paid to the Insurers the appropriate Premium:-

The Total Sum Insured and the Limit of Indemnity are to be increased annually from the Date of Inception of the Policy by the percentage indexation factor shown below. The proportional reduction for underinsurance defined in the General Provision of Average will only apply to the extent that the full rebuilding costs of the Premises exceed the original Total Sum Insured increased by the said percentage indexation factor over the period expired since the Date of Inception of the Policy, to the anniversary of the Date of Inception immediately preceding the date of discovery of an Inherent Defect.

The Deductible stated in the Schedule shall be increased in the same manner annually by the percentage indexation factor shown below.

Such increased Deductible applicable to a claim will be that calculated at the anniversary of the Date of Inception immediately preceding the date of discovery of the said inherent Defect.

**Indexation factor:** \*\*\*\*\*

Subject otherwise to the Terms, Conditions and Exclusions of this Policy Number: \*\*\*\*\*