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Construction All Risks Insurance: Does It Cover All Risks?

I. Introduction

More often than not, insurance clauses in construction contracts are among the last items on the negotiation agenda, discussed – if discussed at all - hastily in between heated negotiations over indemnification and termination clauses. This is perhaps not surprising; having been introduced in 1929 in the United Kingdom as fire insurance rather than construction insurance as we know it,[1] construction insurance is not exactly ancient. The concept is even more alien in Turkey - the first policy was issued around 1960s in more or less the same way, but construction insurance did not become popular until early 2000s as a consequence of the devastating 1999 earthquake that left hundreds of thousands of survivors homeless.

There is no single definition of construction insurance, but it would not be wrong to define construction insurance as a type of insurance that secures the construction of whatever structure is being constructed. As far as construction project practice goes, policies that are "all-risks" appear to be the rule rather than the exception. This article explains what a construction all risks policy is and whether it really covers "all" risks associated with construction.

II. General Framework

All construction projects comprise of three main phases: pre-construction, construction and post-construction. Pre-construction phase typically includes feasibility studies, soil investigation,

[1] Fevzi Topsoy, İnşaat Sigortası Teminatının Kapsamı (Coverage of the Construction Insurance), TBB Dergisi 2018 /134), page 523

design and procurement in advance of commencement of works. Construction phase usually commences with access to site, followed by mobilization of the contractor's personnel, performance of the work, and ends with provisional acceptance of the works, i.e. taking over of the works by the employer of the project. The project ends with the post-construction phase, which starts with taking over of the works by the employer and ends with the expiry of the warranty period (also referred to as the defects notification period), i.e. the final acceptance of the works.

Each of the above-mentioned phases carries different types of risks. By way of example, errors in feasibility studies are in relation to pre-construction phase whereas delays in construction are naturally in relation to the construction phase. These different risks may have different reasons too. For example, natural reasons can be the reason behind a certain risk, and so can humane reasons (the employer, contractor, third parties and the like).

From an insurance perspective, construction insurance is considered to be in the engineering insurance group, together with installation insurance, machine breakdown insurance and electronic device insurance.

From a legal perspective, construction insurance is a contract between the insurer and the insured party. Under Turkish law[2], an insured party is not necessarily the owner of the property as the Turkish Commercial Code ("**TCC**") specifically enables persons who benefit from preventing the risk to be insured parties, which leads to two conclusions: the owner of the project does not need to be the owner of the land or the property, and contractors and sub-contractors or even lenders may be insured parties as well.

As for the legal nature of this contract, it is generally accepted that construction insurance is a type of "property insurance" at its core. Property insurance is included in the wider group of "damage insurance" per the primary legislation that governs insurance policies, the TCC. The reason why construction insurance is considered to be property insurance is because it primarily

[2] Turkish Commercial Code numbered 6102, Article 1453 (1)

insures the benefit over the structure and the material that is used to build the structure.[3] This does not necessarily mean that all construction insurances are property insurances, because this really depends on what the insurance policy covers, as will be explained in more detail below.

III. Construction All Risks (CAR) Policies

Construction all risks policies, which are frequently referred to as "CAR" policies, are the most common among construction insurance policies. Under Turkish law, the main principles of CAR policies are governed by the General Conditions of Construction Insurances (All Risks), which are published by the Insurance Association of Turkey ("GCCI"). The introductory provision of the GCCI provides for a definition of a CAR policy: an insurance securing the values subject to the insurance for loss or damage to be incurred out of unknown and sudden reasons within the insurance period, when they are at the construction site, during construction (save for the exceptions in the policy)[4]. What is covered by the policy is essentially loss or damage.

There are conditions as to what can be indemnified by the insurer: loss or damage must arise out of unknown and sudden reasons. Unknown means that whatever the reason caused loss or damage, it was not known in advance and therefore the doctrine uses the wording "unexpected" instead – and rightly so. This does not mean that the event must be incomprehensible or unpredictable; this simply means that the event must be unexpected and the insured party must not have foreseen the event and/or the consequences in advance.[5]

The GCCI also refers to how an event must be "sudden". Although it might be suggested that any event that is unexpected is sudden, "sudden" is different from "unexpected", because it means that the event must be sudden time-wise. This does not mean that the consequence of the event must be sudden too. By way of example, if an over-loaded crane tilts and then collapses 2 days after tilting, damage would have been incurred in the structure 2 days after the event that actually caused the damage, but the event is nevertheless sudden.[6]

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[3] Ali Ayli, İnşaat Bütün Riskler Sigortasında Riziko, Yetkin 2012, page 55
[4] GCCI Article 1
[5] Ali Ayli, page 68
[6] Fevzi Topsoy, page 532

The main takeaway from this section is that despite what the name suggests, CAR policies do not cover "all" risks. As such, we need to take a look at what possible risks may be covered by a CAR policy.

IV. What does a CAR policy cover?

CAR policies cover a number of events, such as fire, explosion, earthquake, flood, landslide and subsidence, storm, lightning and thievery. These are called the "fundamental" or "essential" risks and are included in almost all CAR policy. Although these are covered by the GCCI in principle, insurance clauses referred to as the "MR Clauses" gain utmost importance as far as CAR policies go, because these are almost always referred to in CAR policies. These are adopted by Munich Re (hence the abbreviation) - a leading insurance and reassurance company, and became the rule of thumb for CAR policies.

Although GCCI principles and the MR Clauses similar, there are some important differences between the two. Fire risk is a good example of this: if the CAR policy does not refer to an MR Clause fire-wise, it means it refers to the GCCI, and the GCCI does not require the insured party to have taken precautions against fire. By contrast, if the fire risk clause refers to the MR Clause that is in relation to fire, then it means the insurer requires the insured party to have taken the necessary precautions to prevent fire. The practical importance of this is that the insurer will not indemnify the insured party if such precautions were not taken.

Each CAR policy may be different from one another, because each policy may have different scopes. This not only depends on what is covered, but it also depends on the type of construction that is subject to the CAR policy. By way of example, if the project is a hydroelectric power plant (HEPP), then it is highly likely that the insurer will include a specific design criterion in the policy, such as the Q25, in order to require the HEPP to be designed per 25 years' of data regarding flow rates and the like.

Regardless of what they do and do not cover, indemnification is always subject to reasons that are unexpected and sudden and the fact that a certain event is covered under the policy will not mean that any event or consequence related to that event will be indemnified. By way of example, if flood is covered under the policy and the site is flooded during excavation works, but the contractor keeps excavating despite the flood, damages will not be indemnified. This is simply because this damage is neither unexpected nor sudden.

There are other limitations, and location limit is one of these. The GCCI clearly states that the CAR policy covers risks as long as the value subject to the insurance is in the construction site. This means that if, for example, a certain item is included in the CAR and that item is transferred to the contractor's factory outside the site, then the insurer will not indemnify the loss or damage. The GCCI also list events which are outside the scope of the CAR policy and these are twofold: the first group (under A.3) includes events which are not normally within the scope, but can be added and the second group lists the events which are excluded from the coverage (under A.4).

The A.3 group includes construction machinery and equipment, temporary worksites, debris or wreck removal, legal liability arising out of loss or damage to be sustained by third parties. It is noted in the first section of this Article that construction insurances are not necessarily damage-only insurances, and this is a good example of this because "liability", if included, would mean that the policy is a combined policy, i.e. a mixture of damage and liability insurance.

Importantly, this group also includes, the "maintenance phase" of the construction[7] and the maintenance coverage is defined as a coverage that starts with the completion of the construction, or provisional acceptance, or the taking over of the works by the employer, or the usage of the works by the employer and ends with final acceptance.[8] Within the context of construction contracts, this period is commonly referred to as "warranty period" or "defects notification period". Accordingly, if maintenance coverage is included in the CAR policy, then the insurer must indemnify the insured party if the contractor causes loss or damage during the warranty period, when remedying defects or deficiencies or loss or damage that arises out of

[7] GCCI, Article A.3
[8] GCCI, Maintenance Phase Clause

other reasons for which the contractor is responsible. It is vital to note that the CAR policy will not be valid through the warranty period unless added to the policy.

This is further reinforced by Article A.4 of the GGCI, as it states that the CAR will not cover loss or damage once the construction is completed, or taken over, or is used by the employer unless there is a separate maintenance coverage agreed. Article A.4 further states that the CAR policy will not cover any direct or indirect loss or damage in any part of the construction if the maintenance period, i.e. warranty period is over. This is a different and equally important issue in terms of warranty periods, because this simply means that it is not possible to include (from the GCCI's perspective) coverage after the warranty period expires.

The practical importance of this is perhaps more relevant in works which are divided to sections (as allowed, for example, under the FIDIC contracts) or for works which are not divided to sections per se, but are nevertheless taken over at different times. Parties would be well advised to align the expiry of warranty periods and make sure that the policy reflects this understanding.
On this note, it should be clarified that the fact that the warranty period works might not be covered under the CAR policy does not mean that the contractor is not liable to indemnify the employer for any loss or damage that it might cause. Insurance is essentially a way to ensure that the loss or damage will be covered by a third party (if the policy allows it) but it is not a way by which the liability between parties is determined or allocated. Insurance is a mechanism whereby the risk of indemnification is shifted, or transferred, or divided between parties. As a result, the expiry of a CAR policy or the fact that a CAR policy – or any policy for that matter – does not cover a certain issue will not mean that parties will not be liable against each other. The contractor, for example, may be liable to the employer for up to 20 years under Turkish Law for defective work if the defective work is the result of gross fault[9]. The only difference is that, the insurer will not be liable to indemnify anyone. Therefore the key is to allocate liability in the contract and it is of particular importance to determine which party will be liable for an event that is outside the scope of the CAR policy.

[9] Turkish Code of Obligations numbered 6098, Article 478

Warranty period is by no means the only event that is outside the scope of an ordinary CAR policy. Article A.4 includes other important exclusions, such as damage caused by public authorities, damage caused by machinery or device breakdowns, defective material and indirect damages. Some of these can be included in policies, albeit with a much increased insurance premium.

There are other cases which might result in different consequences regarding the premium, an example of which is suspension of works. Suspension of works is not something that is clearly defined under the law, but it is allowed by most contracts. Take 1999 FIDIC as an example – the employer will be allowed to suspend works and will not even be under the obligation to inform the contractor of the reason. Suspension will, after a certain amount of time passes, lead to the entitlement to terminate the contract. These will have impact on the CAR policy. Per GCCI Article A.5/3, if the works are suspended for more than one month (continuous) then the works will cease to be covered by the CAR if and when the insured party notifies the insurer. Failure to notify the insurer will result in an unwanted outcome, because if the suspension is not notified, then the CAR policy coverage will be maintained but when the construction is not completed per the time for completion, the insurer will request additional premium anyway. On the other hand, if suspension is duly notified, although the insurer may still require additional premium, it will also extend the policy by the amount of time that the works had been suspended.

This is quite relevant as of the date of this article, as the "Coronavirus" outbreak (commonly referred to as COVID-19) which is caused by "a new strain that was discovered in 2019 and has not been previously identified in humans"[10] is taking a toll on practically every sector including construction. At first glance, it might seem like the COVID-19 outbreak is not exactly relevant within the context of a CAR policy. However, it may well be relevant if the project is suspended due to force majeure. The parties to the insurance policy are therefore well advised to check the notification requirements under their CAR policies and reach out to insurers to discuss what their options are in terms of indemnification and/or extension of the policy.

[10] https://www.who.int/health-topics/coronavirus (last accessed 20 March 2020)

V. Conclusion

CAR policy is the most common construction policy around, and for good reason too. Instead of insuring all the risks that may arise in a construction project separately, it is in all parties' interest to have a single, consolidated policy which clearly sets out what is insured and what is not.

A CAR policy does not cover all risks that surround a construction project and the reason why it is called an "all risks" policy has more to do with it being a consolidated policy rather than an all-inclusive policy. As such, parties would be well advised to check what is covered by a particular CAR policy, and if they have specific requirements as to the terms and conditions, then to clearly express these in the contract. The same goes for the exact conditions of indemnification under a policy, and the precautions, if any, that needs to be taken by each party so that the insurer will indemnify the insured party in accordance with the policy.

It would be a mistake to assume that a CAR policy covers everything there is to cover in relation to a construction project. Parties should always keep in mind that due to its length and complexity, a construction project bears all sorts of different risks from feasibility to warranty period and the most robust way to manage the risks is to have a robust insurance policy in place.