In the construction space we have previously seen insureds, and their brokers, exerting pressure on insurers to write policies with cover specifically extended for claims against an insured for breach of a fitness for purpose warranty.

In the current market the appetite to provide such broad cover appears to be diminishing.

This article discusses the implications of providing cover for fitness for purpose warranties.

1. What is a Fitness for Purpose Clause

A typical express fitness for purpose wording has the following effect:

[The Consultant] warrants that all work, documents and deliverables it produces are fit for purpose.
Design and construct contracts (D&C Contracts) might include fitness for purpose clauses which operate to hold consultants responsible for ensuring their work is appropriate for the principal’s intended purpose. i.e. The end-product must, when the work is finished, be appropriate and suitable for the purpose of the principal.

Standard form consultancy agreements such as AS4122-2010 do not include a fitness for purpose warranty. The agreement is often specifically amended by the principal to include the warranty as an amendment or special condition.

Davies J spoke about the virtues of implied fitness for purpose clauses in Viking Grain Storage Ltd v TH White Installations Ltd as:

> It prescribes a relatively simple and certain standard of liability based on the reasonable fitness of the finished product, irrespective of considerations of fault and of whether its unfitness derived from the quality of work or materials or design. [1]

In layman’s terms, the fitness for purpose clause imposes a professional duty on the consultant to "be right" as opposed to merely requiring them to "be careful".

It places a greater obligation on the consultant than the mere exercise of reasonable skill, care and diligence and even where the consultant has conducted itself in accordance with, or even above its professional standards, the consultant may still be liable for damages in breach of a fitness for purpose clause.

As with any contractual provision the true extent and application of any specific fitness for purpose clause requires interpretation of the contract and the surrounding circumstances.

Principals are motivated to employ these clauses because they offer a "one stop shop" for the principals to rely on if something in the project goes wrong. Additionally, the onus of establishing a breach of a fitness for purpose clause is less than if they were required to prove a consultant’s negligence.

2. Usual position in insurance contracts

Consultants face a conundrum if they agree to a fitness for purpose clause as an express term of its contract with the principal.

On the one hand, a principal might insist on a fitness for purpose warranty from its consultant. On the other, if a consultant agrees to such a clause it runs the risk of being uninsured for potential claims for breach of that warranty. This is because ordinarily a consultant’s professional indemnity insurance would not respond to a claim made against the insured under a fitness for purpose clause.

Professional indemnity insurance is a product which covers liability to a third party for a breach of a professional’s common law duty, not for liabilities assumed under a contract. It is therefore common, in insurance products, for contractually assumed liabilities to be excluded (Contractual Liability Exclusion). Where a liability only arises because of an agreement entered into by the insured and where that liability would otherwise not exist (for example, there is no negligence by the consultant in its provision of services) that liability would be excluded. In those circumstances section 54 of the Insurance Contracts Act does not provide insureds with any relief. Further even if the consultant were negligent, a Contractual Liability Exclusion would operate to remove insurance cover for any additional liability assumed by the consultant as a result of the fitness for purpose clause.

3. The increased risk assumed by insurers
A more recent trend that we have observed in the construction space is insurers offering to expressly write back cover, by way of endorsement or extension, for breach of a fitness for purpose clause.

Even though fitness for purpose clauses have been present in design and construct contracts for some time, it is a relatively recent development for this risk to be underwritten by insurers.

**Uncertainty of risk**

A fitness for purpose clause can often represent an indeterminate exposure for an indeterminate period. Insurers who agree to insure fitness for purpose clauses should know that if they agree to provide cover they assume this unknown exposure.

Relevantly some agreements containing fitness for purpose clauses do not state the intended purpose of the work. The practical effect of this is that it allows a wide scope for argument as to whether or not the work is fit for the purpose. That increases the potential for drawn out and costly litigation.

If insurers agree to provide cover for fitness for purpose in an annual policy (as opposed to a project-specific policy), there is no certainty as to the number of contracts an insured has entered into or will enter into which warrant fitness for purpose. The number of risks covered will not be known, and the terms of each of the insured’s contract (specifically, the fitness for purpose wording) will not be known to insurers at the time of policy inception. While this uncertainty can be mitigated through the use of a retroactive date, it illustrates the risks for insurers.

**Risks associated with specific projects**

There are certain types of projects which carry a greater risk of a consultant falling foul of a fitness for purpose clause.

Projects which inherit a more significant risk of breaching a fitness for purpose clause are those in which the design of the project incorporates a minimum target for output. Examples of these projects may be power plants, toll roads, and desalination plants. If the design requires a specific level of performance, and the finished project does not produce that minimum level of performance or output, the consultant is likely to be in breach of the fitness for purpose clause.

Breaches of this type could occur for a number of external reasons which could not have been anticipated or altered by the insured consultant, but it will be liable for the loss under a fitness for purpose warranty. If cover has been extended to an insured then this liability will be passed onto its insurer.

These risks may be agreed between the principal and the insured consultant after the inception of a policy and exposes the insurer to risks which it may have not anticipated during the underwriting process.

**4 Additional considerations**

Where insurers wish to offer cover for breaches of express fitness for purpose clauses in construction professional indemnity products, the following should be considered and potentially implemented to provide greater certainty of the risks being written.

- Insurers may consider only offering fitness for purpose cover on a project specific basis, rather than on a yearly policy period. By doing so, insurers are more likely to have the opportunity to consider the D&C Contract and the relevant fitness for purpose clause. It may also provide insurers with greater control over the amount of fitness for purpose risks they write at any one time.
Consultants who are unable to obtain insurance cover for such clauses can, quite sensibly, point out to the principal that any perceived benefit of having such a clause is of limited utility where there is no insurance behind the consultant.