

Explore the Law's Approach to Liability for Pure Economic Loss in Construction Contracts

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Abstract

This paper discusses the liability in case of economic loss in construction contracts. It starts with a brief introduction about the construction contract and the essentials of a contract according to the Indian Contract Act, 1872. All the types of construction contract are also discussed in great detail in order to give a better understanding of the construction contracts. General liability insurance for the contractor and the contractors' all risk insurance have been discussed. Insurance is an important aspect of a construction contract to avoid unnecessary expenses incurred in lawsuits or paying damages to the clients or any other third parties. The paper ends with a discussion on why insurance is important in the construction contract.

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Introduction

India is one of the fastest developing countries in the world. One of the most important aspects for any country is its infrastructure and hence every country tries to improve it year by year. Infrastructure involves buildings, dams, roads, etc. When any infrastructural development task is taken, whether big or small, it involves a great deal of planning on how the development will be done, what kind of material and under what timeline it is to be completed, etc. Hence, the number of contracts for the construction is being entered into which specifies the rights of the parties and what to do in case of any contingency and etc. Since construction is a complex task and involves a number of people, the construction contracts are generally complex and include a number of small contracts with contractors, labor, etc. It is due to the complexity of such contracts it becomes necessary to study them in detail in order to understand it in a better way.

Hypothesis

Construction contracts are very important in construction activities to determine the liability of all the parties. A situation may arise where there is some liability on the contractor to pay for certain losses and damages. Such losses and damages can be of any amount and can also force the contractor to stop the business or construction activities. In order to avoid such setbacks, insurance is necessary to be taken by the contractors. Insurances can save the contractors by paying the damages and the costs of lawsuits against the contractor.

Research Methodology

The research methodology that will be used in this study is doctrinal. A number of books and literature will be referred to. To be able to gather the latest development and more details into the topic different websites and article will be referred to.

Construction Contract

A contract which is for construction of roads, buildings and other works is a contract for construction or construction contract. In other words, a construction contract is an agreement between two or more parties for the purpose of construction. The complexity of such a contract depends upon the magnitude of the project. There may be only one contract if the magnitude of work is small or there may be a number of contracts where the project is a large one. There are no special requirements for the construction contract but basic elements of the contract have to be observed.

What is a Contract?

Agreement is defined in Section 2(e) as “every promise and every set of promises forming the consideration for each other”². And a promise is defined as an accepted proposal. Section 2(b) says: “A proposal, when accepted, becomes a promise”³. This is another way of saying that an agreement is an accepted proposal. A contract is an agreement; an agreement is a promise and a promise is an accepted proposal.

An agreement is regarded as a contract when it is enforceable by law. The conditions of enforceability as per section 10 are that an agreement is a contract when made for some consideration, between parties who are competent, with their free consent and for a lawful object.⁴

A contract which satisfies all the requirements of a valid contract and is for the purpose of construction is a construction contract.

2 Section 2(e), Indian Contract Act, 1872.

3 Section 2(b), Indian Contract Act, 1872.

4 Section 10, Indian Contract Act, 1872.

Types-

There is four types of a construction contract.

1. Lump Sum Construction Contract – In this type the contractor bids a single fixed price for overall activities. The contractor is responsible for approximate the project costs from the drawings and then adds overhead costs and his profit to determine the price of the project. No risks are carried by the owner and all the risks are assigned to the contractor. The contractor has an incentive in the contract as he is rewarded for completing the project early and there is a penalty for the late finish. It is an ideal contract when the scope of the project is well defined at the design stage as there is limited flexibility in modifying design during the construction period.
2. Unit Price Construction Contract- Price of each item determines the total price of the project. The contractor is paid as per the rate of specified items. The risk is taken by both the contractor and owner. It has more flexibility in design changing than a lump sum contract. The construction can be started before finishing the design so the total cost of the project will be uncertain at the early stages.
3. Cost plus Construction Contract- The contractor is paid on the basis of the actual cost of the project including direct and indirect cost plus specific fee. All the risks are bear by the owner and he is also involved with the contractor in the management of the project. There is no risk for the contractor in case of increasing the cost of the project, also no incentive is there for finishing early. It is an ideal contractor when the project scope is uncertain at the early stages of the project. The contractor can execute the project before finishing the design. It is not possible to determine the cost of the project before the construction finishes.
4. Target Cost Construction Contract- It has the mutual features of the lump sum and cost-plus contracts. The contractor is paid on the basis of the actual costs plus

certain fee either fixed or percentage of total cost in case the project cost doesn't exceed certain target cost specified by the owner.

General Liability Insurance for Contractors

Construction works involve some of the most diverse and risky works. In some of the construction works clients are allowed to visit, and if the clients get hurt on the property, their medical bills could become a contractor's liability or responsibility. The contractor can be held responsible for the products like cabinets installed in the kitchen if they cause any harm.

To address these risks general liability insurance can be relied on. This type of contractor insurance offers lawsuit coverage for accident, injuries, and some work mistakes. This protection can be invaluable in case of expensive lawsuits which can be a setback for the contractor.

How General Liability Insurance Protects Contractors

General Liability Insurance benefits contractors in three different ways:

1. Asset Protection – It provides protection from damages to be paid to a third party on an allegation of causing bodily injury or property damage by the business.
2. Survival Plan when things go wrongs – It covers expenses in case of unpredictable accidents which can jeopardize the business.
3. Protection for business and employees – It protects the employees and business from all type uncertainties. It protects the business against the claims brought against the company as a whole, as well as a claim brought against an individual employee of the company.

It can cover legal fees such as attorney fees, witness fees, court expenses, and more.

Claims Covered

1. **Bodily Injury Claims** – In labor-intensive industries, no matter how careful a business is, accidents occur, especially when untrained visitors enter a worksite. If someone gets injured in the worksite premises the policy pay may for the third party's medical expenses and court-awarded compensation.
2. **Property Damage Claims** – General liability insurance protects the contractors from lawsuits which alleges that the contractor's business damaged their property. It is important to note that it does not cover damage caused to the client's property in case of remodeling.
3. **Completed Products Claims** –It helps in paying for claims related to services completed and [products produces. So if in case some cabinets installed by the contractor causes injury to the homeowner, the contractor can be held liable for the injury. But, with the insurance, legal expenses and damaged can be covered.
4. **Faulty Workmanship Claims** – The cover for workmanship related faults like noncompletion of the project on time or went over the budget, etc. may be included in such a policy.
5. **Personal and Advertising Injury Claims** – It covers the injuries like copyright infringement, privacy invasion, libel and slander during the advertisement.
6. **Immediate Medical Expense Claims** – The policy may help in covering immediate medical expenses in case of injury to a client or a visitor.

All Risk Insurance for Contractors

All risk insurance for contractors is also known as Contractors' all risk insurance (CAR). It is a nonstandard insurance policy which provides coverage for property damage and third-party injury or damage claims. Damage to property includes improper construction of structures, damage during a renovation and damage to temporary work which is erected on-site. Sub-

contractors and third parties may get injure while working at the construction site. Contractors' all risk insurance policy covers all the associated risks. For construction projects like buildings, water tanks, flyovers, sewage treatment plans, and airports.

Generally, multiple parties like a contractor, an employer with other third parties such as financing companies take out the Contractors' all risk insurance policies. Since multiple parties are included, all such parties retain the right to claim against the insurer. All the parties have the duty to inform the insurer any injuries and damages that may result in a claim. The goal of such policies is to ensure that all the parties are covered on a project, notwithstanding the type of damage to the property and who caused it. In such policies, the insurer if it pays out funds to one party in the contract cannot recover those funds from another party in the contract.

Risks like a flood, wind, earthquakes, water damage, and mold, construction negligence and faults are covered under Contractors' all risk insurance. A Contractors' all risk insurance policy also provides coverage against damages or losses caused by the fire to the property. Typically, it does not cover normal wear and tear, poor workmanship or wilful negligence.

The policy extends to Drilling work for water wells, third-party liability, earthquake, escalation, act of terrorism, extended maintenance cover, limited maintenance cover, clearance and removal of debris, cross liability, damage to owner's surrounding property, inland transit, contractor's plant, and machinery, serial losses, break of policy conditions, loss or damage due to strike/riot/civil commotion, vibration/removal or weakening of support, fire fighting, automatic increase clause and others.

Need for Insurance

The construction activities involve lots of labor-intensive work. Any unforeseeable accident can happen at any time. An insurance policy is the best way to get protection from lawsuits or claims which can have a setback on the business of the contractor.

The clients may make it necessary for the contractor to have an insurance policy. Generally, clients want some proof of liability coverage before the work of the project begins. By policy, they have the assurance of claiming losses in case of any harm. The liability of a contractor is multifold and therefore, in order to avoid unwanted costs, it becomes necessary to have insurance in place.

Conclusion

Construction of projects either big or small involves one or more contracts which determine the liabilities of parties, the time of completion of a project and other terms. It also determines what actions or remedy is available in case of breach of any terms and conditions of the contract. Construction activities involve plenty of risks which can give financial setbacks to the contractors. In some cases, such setbacks also lead to the closing of the entire business. Hence, in order to have a safe and secure future for business, insurance in construction contracts is necessary.