



# The Impact of Inflation on the Scope for Professional Negligence Claims in the Construction Industry



## Introduction

Rising inflation is putting even more financial pressure on contractors who already operate within the confines of slim profit margins. Therefore, we think rising inflation enhances the risk of professional negligence claims being made in the construction industry.

**We have, therefore, set out a short commentary on some of the issues.**

## An Enhanced Atmosphere for Claims

Broadly speaking, in our view, rising inflation can create an atmosphere where professional negligence claims in the construction arena are more likely. For example:

- i. Where inflation is causing costs of materials and energy to rise, then that can reduce a contractor's profit margin which already may be slim. That is particularly so when the contract is a fixed price contract without a contractual entitlement on the part of a contractor to adjust the contract sum in these circumstances. In very broad terms, where there is a problem with a project, the issue can sometimes be resolved commercially by the parties involved without a formal claim being made. There is a better chance of that happening if a contractor is going to make enough profit out of the project. It follows that where rising inflation results in a contractor's profits being diminished or eradicated, then in the event of a problem on a project we can expect an increased chance of claims being made as opposed to being dealt with commercially within the project. Such claims could include professional negligence claims.
- ii. Furthermore, where margins are tight and inflation is increasing, then a consequence of that could be a deterioration in construction quality where contractors are trying to reduce costs generally including, say, costs spent on workers. That in turn can increase the scope for professional negligence claims. For instance, if an Insured is acting in a contract administration or supervisory capacity you might expect to see claims for defective workmanship passed on to them.

## An Increase in the Value of Claims against an Insured

If there is a professional negligence claim which includes a claim for damages in respect of remedial works and, due to inflation, the costs of implementing those remedial works have increased, then you would expect a professional negligence claim with an increased value, which could in certain instances be very significant.

## An Increase in the Value of Claims – Under Insurance & Subrogated Recovery Considerations

The increased value of professional negligence claims could make subrogated recoveries more difficult for insurers. For example, if an Insured faces a professional negligence claim due to the negligence of a sub-contractor, then the ability to make a subrogated recovery can in large part be dictated by the level of insurance being maintained by the sub-contractor. The level of insurance required by a contract and/or any cap on liability should be decided by having regard to different factors including the anticipated cost of rectifying a problem caused by the sub-contractor if that sub-contractor were to be negligent. Where the sub-contract between the Insured and the sub-contractor was agreed before inflation was a live issue, then from the perspective of seeking a subrogated recovery it might be that the level of insurance that the sub-contractor is required to maintain / any cap of liability may not be adequate in light of the increased claim value caused by inflation.

## Rising Inflation & Insolvency

It could be said that rising inflation generally could increase the risk of parties to a construction project becoming insolvent. Insolvency can have different adverse consequences from a claim's perspective including the following:

- i. Where a party primarily responsible for a problem on a construction project is insolvent, the result can be that people look to make a claim focussing on solvent parties even though they may be less culpable.
- ii. Furthermore, where, say, two parties are jointly responsible for causing a loss then the default position is that they are both liable for the **whole** loss even though each is **partially** responsible. Where one of those two parties is insolvent, you might expect to see a claim against the solvent party for the whole loss even if they were, say, only 10% responsible. Furthermore, in that case, the solvent party would not have a viable claim for indemnity or contribution against the insolvent party and would be left to pay the whole loss (unless there was insurance in place to cover that claim). For completeness, it is worth observing that net contribution clauses mitigate against this problem.
- iii. If you are dealing with a claim where the Insured is insolvent (say a direct claim against insurers under the Third Parties (Rights against Insurers) Act 2010), then there can be practical difficulties in seeking to defend those claims. As an example, those individuals involved in the project may have moved on to other jobs and be less inclined to assist in the defence of the claim.

Overall, rising inflation is a factor which could have a significant impact on professional indemnity claims in the construction industry.

### Further Information

Given the generality of the note it should not be treated as specific advice in relation to a matter as other considerations may apply.

Therefore, no liability is accepted for reliance on this note.

If specific advice is required, please contact one of the Partners at Caytons who will be happy to help.

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