

Risk and insurance in construction: insurance contracts used in investment process in Poland – legal and economic aspects, survey research

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Abstract

Insurance is a vital element of risk management in the construction industry. Every participant of an investment and construction process may take out insurance for their business activities and the range of products offered by insurers on the construction market in Poland is very wide. Therefore, contractual parties need to possess professional knowledge in the field of insurance suitable for the construction industry. It is particularly connected with legislative aspects, including the legal wording of an insurance contract to be concluded between the insured and the insurer. That is the main issue that the paper deals with, aiming to discuss the use of insurance by participants of an investment and construction process in Poland. The paper is synthetic in its character. Theoretical deliberations are supplemented with the results of the empirical research conducted among a group of thirty-four construction and assembly companies operating in Poland.

Key words

risk, insurance, contracts, contractors, construction industry, Poland

JEL Classification: G22, G32, K12, L74

Introduction

In practical investment and construction processes, risks tend to be insured. A vast array of insurance products, offered by insurance companies which are present on the Polish market, are used to that end. Insurance is a specific element used in practical risk management in the construction industry. Insurance is now commonly deployed as a risk-financing method in construction and assembly companies. The paper outlines the types of insurance available in Poland to secure the performance of investment projects. The aim of the paper is to discuss the most important questions in this area. In particular, it focuses on legislative aspects and regulatory acts which govern the construction insurance market in Poland. In addition, the paper, in its part two, presents the results of the empirical research. In general, the conducted research concerns the use of insurance in operations of the largest construction and assembly companies in Poland. The empirical research was carried out among the selected thirty four contractors and the main research method was a survey interview, supplemented with face-to-face interviews. A criterion for the selection of entrepreneurs to take part in the research was their turnover (in PLN million) for the previous financial year. Among the surveyed entities, there were construction and assembly companies included in the WIG-Construction (WIG-

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Budownictwo) index on the Warsaw Stock Exchange. The research was carried out in April and May, 2012 within a research project at the Department of Investments and Real-Estate, the University of Economics in Katowice. Its author is P. Tworek, who also authors part 2 of the present paper. In addition, he wrote the introduction to the paper and summarised the conclusions. Part 1, in turn, was written by M. Tomecki, a legal trainee in the District Chamber of Legal Advisors in Katowice, who outlined the main legislative issues, which are presented in the paper in connection with insurance in the Polish construction industry. As a consequence, the paper is interdisciplinary in its character, i.e. it discusses the problems which are analysed from legal as well as business points of view. All these issues are presented in the paper in a synthetic way.

1. Insurance in Poland in the light of legal regulations

Contract conclusion principles and a normative model of an insurance contract, including detailed clauses describing parties' rights and obligations, are based on valid assumptions given in the national legislature. In general, there are certain differences between specific legal systems. Therefore, when investing in a given country, one should closely analyse the legal solutions which are regarded as acceptable there. Under the Polish law, an insurance contract is a normative type of contract. The format and content of such a contract are defined in legal acts and a number of executive regulations. The main source of law which refers to insurance contracts is the Civil Code [1] which, in articles 805-834, describes the normative model of such a contract. The Insurance Activity Act [2] contains provisions which directly refer to insurance contracts, giving the grounds, e.g. for the voluntary nature of insurance (art. 12 of the Act) and specifying the contents of general terms and conditions of insurance (art. 12a of the Act). Furthermore, in Poland there are specific acts in force, such as the Insurance Intermediation Act [3] and the Act on Compulsory Insurance, Insurance Guarantee Fund and the Polish Motor Insurers' Bureau [4] which, in a way, determine the obligations connected with the conclusion of insurance contracts and introduce, in some cases, the requirement to conclude an insurance contract, as an exemption to the general rule that insurance should be voluntary. It should be added that in the Polish legal system, it's possible to use a foreign law in insurance contracts concluded in the territory of Poland by domestic and foreign insurers. Such a solution is an exception to the rule, stating that the Polish law should apply, and is subject to art. 28 of the Private International Law Act [5], but is permitted. Under art. 805 § 1 of the Civil Code, an insurer commits to make a specific performance if an event provided for in a contract occurs, and the insured commits to pay a premium. This is a reciprocal contract to be concluded on a paid-for basis [6]. The contractual parties are the insurer and the insured. However, also other subjects may appear, with reference to the insurance relationship between these parties. The main insured entity is a party who is exposed to an insured risk and for whom the insurance is concluded [7]. The general terms and conditions of insurance, however, or the contract may indicate another entity, i.e. a third party, as the insured one - art. 808 § 1 of the Civil Code. For instance, an investor may demand that the contractor, who is to carry out construction works, should enter into an insurance contract to cover consequences of a specific event during the construction process, but they may reserve it in the contract that a compensation is going to be paid to an investor, instead of the policyholder [8]. The obligation to enter into such an insurance contract may arise out of a concluded contract for construction works [9]. In third party liability insurance, an aggrieved party may appear as the participant of the insurance contract to whom the insured is held liable. In execution of investment projects, such insurance may cover liability under a contractor's warranty to an investor.

Consequently, if the contract is not completed or is not duly completed, the insurance carrier will be liable to pay a compensation to the investor.

The Polish regulations stipulate that a policyholder may only be an entity which conducts business by providing insurance activities. Therefore an insurance contract is a qualified contract [10]. The manner for conclusion of insurance contracts is set out in the provisions of art. 809 - art. 815 of the civil code. Such contracts tend to be concluded by way of offer and acceptance. The policyholder submits an insurance request to an insurance carrier. Under art. 66 of the civil code, such an offer has a binding effect on the offeror under general rules. The provisions of art. 809 ff are used predominantly when a contract is adhesive in its character and is concluded based on general terms and conditions of insurance [6]. A particularly vital thing for the protection of contractual parties' interests is the knowledge of general terms and conditions of the contract. If the contract is concluded by adhesion (an adhesive contract), then it's concluded based on general terms and conditions of insurance. In accordance with previously mentioned art. 12a of the Insurance Activity Act, general terms and conditions should specify: type of insurance, object of insurance, conditions for amendments, the insurance sum, the method of determining a damage, the method of determining a compensation to be paid out, the method for determining a premium, the manner and conditions for amending the contract. Under the effective regulations, such a contract may also be concluded implicitly (*per facta concludentia*), by tender or auction. Taking into consideration the needs of complex investment projects, an insurance contract may also be entered into by negotiations, in particular when such a contract is to be concluded with an economically strong business partner or in a situation when risk to be covered by insurance is untypical and an insurance carrier doesn't have any general terms and conditions which would suit this situation [10]. No matter how the insurance contract is concluded, the provisions of art. 809 § 1 of the civil code require that the insurer is obliged to confirm execution of the contract by an insurance document with effect *ad probationem* (which is also reflected in jurisdiction). The civil code regulations indicate which components of an insurance contract are essential (*essentialia negotii*). A required component is the identification of the object of insurance, e.g. the object of an accident or a risk. In case of property insurance, such an object is every property interest which is not unlawful and may be assessed in money – art. 821 of the civil code. This concerns a property value or an item which can be estimated that are exposed to a risk [11]. In third party liability insurance, this may be the definition of a type of damages suffered. The insurance contract should define fortuitous events, which are covered by insurance. In the insurance contract, the parties specify their mutual performances. The policyholder is obliged to pay an insurance premium to the insurance carrier. In Poland there is a rule that a premium is a one-off performance but parties may agree differently, under art. 813 § 2 of the civil code. An insurance carrier, in turn, undertakes to meet the performance in case an accident anticipated in the contract occurs. This performance, depending on the type of insurance, may come in form of a compensation up to the insurance sum (art. 824 § 2 of the civil code.) or a sum guaranteed [7]. The insurance sum is a specified top limit of insurance. As a rule, in case of property insurance this amount cannot exceed a loss incurred due to a specific event covered by insurance. However, under art. 824 § 1 of the civil code, it may be otherwise agreed in the contract. In Poland, there is a rule that compensation should be made in cash which means that a damage is remedied by payment of an adequate amount of money, not by a restitution in kind. The amount of performance the insurer has to pay depends on the type of insurance. In third party liability insurance, the value of compensation is based on general civil law principles, which include, but are not limited to, the following ones:

- the principle of full compensation (real losses - *damnum emergens* and lost profits *lucrum cessans*),
- contribution to the damage arising or increasing (art. 362 of the civil code) [7].

In property insurance, there is a principle that a contribution to be paid by an insurance carrier covers only actual losses [10]. The effective regulations give an option of limiting an insurer's liability for contractual reservation of a conditional franchise, an unconditional franchise or a deductible [12]. It should be added that the civil code regulations governing insurance contracts are, in the majority of cases, peremptory in their nature (*ius cogens*). This is highly significant for the freedom of concluding contracts. In case when provisions of an insurance contract or the general terms and conditions of insurance are contrary to the regulations of chapter 17 of the civil code, they are invalid unless further regulations provide for exceptions (art. 807 § 1 of the civil code). Such a solution has a big impact on the freedom of contract.

Insurance used in investment projects may take various forms. Under such contracts, insurance may cover damages incurred in a few stages of an investment project (e.g. the construction stage or the operational stage), or it may be limited to a specific stage only [13]. The scope of insurance is strictly reliant on the needs of a given undertaking. Looking at insurance used at the construction stage, the following types of insurance contracts may be mentioned:

- all risk insurance contracts (insurance against all construction and assembly risks) – in the professional literature such contracts are referred to as CAR (*construction all risks*) contracts and they cover risks connected with a physical loss of or damage to materials and equipment kept on a construction site, consequences of a force majeure event, except for events explicitly specified in an insurance policy [14];
- insurance contracts for goods in transit – they contain an obligation to pay a compensation in case when any property is lost or damaged when being transported and unloaded at a construction site;
- contracts of third party liability insurance – such insurance covers any damages caused to third parties;
- insurance contract for losses due to delays in putting into use – under such insurance a compensation is paid for losses due to lost profits (*lucrum cessans*) or additional costs (*damnum emergens*), which are caused by the failure to put the facility in operation in due time;
- contracts of force majeure insurance (*vis maior*) – such contracts provide for a compensation in case of any force majeure events caused by forces of nature (*acts of god*) i.e. a flood, a fire, a hurricane, an earthquake and violent political events such as a war, a strike, a boycott or an embargo [15].

At the operational stage of an investment process the following types of insurance contracts tend to be used:

- insurance contract for all operational risks,
- contract of third party liability insurance,
- business interruption insurance,
- force majeure insurance.

Summing up, under the Polish law two groups of insurance policies can be distinguished: insurance of property and insurance of persons. It should be added that in Polish business practice, the types of property insurance used in construction works include, as mentioned by D. Okolski, third party liability insurance for specific participants of a construction process (i.e. a designer, a contractor, a subcontractor) and insurance against a damage to property [9].

The insurance for individual participants of the investment process covers both direct damages (*damnum emergens*) and consequential damages (*lucrum cessans*), which result from an identified behaviour of a project participant, e.g. defective performance of construction works by a subcontractor. In construction of such insurance, parties use the right to freely conclude agreements, therefore they may take out insurance for [9]:

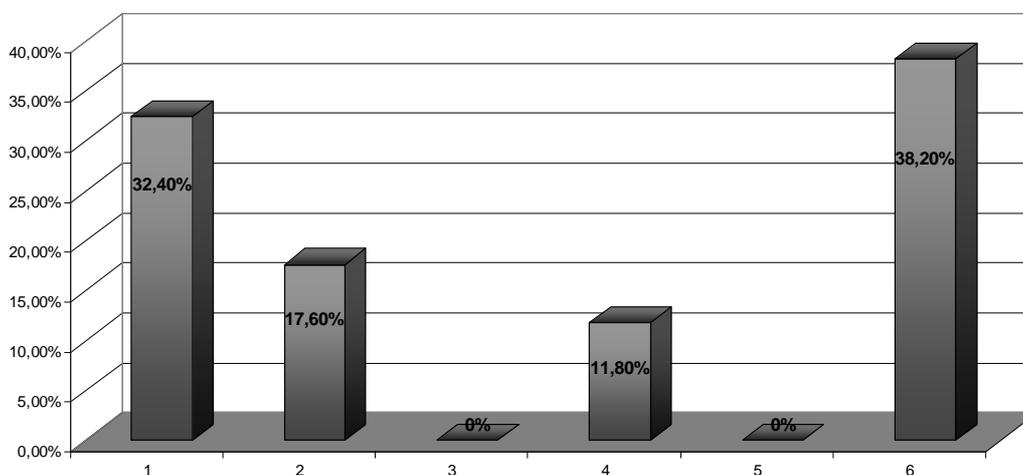
- liability for warranty for physical defects;
- liability for damages to third party's property due to a defined action or omission by a participant of an investment project [9].

In some cases, the Polish law imposes an obligation to conclude an insurance contract. Regulations issued on the basis of a statutory delegation state that an appropriate contract has to be concluded. Such an obligation concerns third party liability connected with the performance of certain professions, e.g. the professions of a lawyer, a legal advisor, an architect or a construction engineer [16]. The participation of freelance professions in the execution of a given project may lead to significant financial losses, e.g. due an error in a technical design, incorrect legal advice. Therefore, the legislators have imposed the obligation to take out third party liability insurance. Such a solution strengthens an investor's position in case of any occurrence which may result in third party liability of an entity, which is subject to obligatory insurance.

2. Insurance in the activities of the largest Polish contractors – a selected fragment of the research findings

As emphasised in the introduction, currently insurers operating on the Polish market offer a wide range of insurance products designed for the construction industry. Their offerings differ. The key criterion when selecting an insurer (an insurance offer) e.g. by contractors, is a price of an insurance policy. In other words, an insurer sells to a contractor, at a specific price (the cost of insurance for the contractor), a service which involves the insurer's taking over the burden of risk consequences [17]. It should be added here that also other criteria, apart from a policy price, are considered in business practice. These criteria were indicated by the contractors themselves during the research. The research results, as shown in Fig. 1, indicate which insurers' offers are most popular among the contractors.

Figure 1: Insurers whose offers are used by surveyed contractors
(construction and assembly insurance)



- 1 - PZU S.A.
- 2 - TUiR Warta S.A.
- 3 - Commercial Union
- 4 - UNIQA
- 5 - Compensa
- 6 – other insurers

Source: prepared by the author on the basis of the replies given.

Figure 1 shows just the selected insurance companies, which operate on the Polish market and provide insurance services in the area of construction and assembly. From among the insurers shown in Fig. 1, 32.4% of the contractors use the services of PZU S.A. None of the respondents answered that they had taken out insurance for their construction and assembly activities from Commercial Union or Compensa, which are typical foreign insurers present on the Polish market. At the same time, as many as 38.2% of the contractors chose other insurers. In the survey they mentioned, among others, InterRisk S.A., Generali, PTU-Polskie Towarzystwo Ubezpieczeń S.A., ALLIANZ Polska S.A., HESTIA, AVIVA Towarzystwo Ubezpieczeń Ogólnych S.A. As emphasised before, the choice of a specific offer i.e. an insurer, is determined by a number of factors, such as the cost of an insurance policy and terms and conditions of insurance, as indicated as the first criterion by almost all the contractors surveyed. (Some contractors also indicated the speed and flexibility in issuing policies (guarantees), the amount of franchises, efficient customer service, an insurance company's reputation and credibility, high effectiveness in claim adjustments, a possibility to negotiate affordable premiums, a possibility to add additional clauses, a possibility to expand insurance cover (flexibility), the size of an unconditional franchise, timely payment of compensation). For instance, TUiR Warta S.A., i.e. one of the oldest insurers on the Polish market, provides insurance cover (for construction and assembly works) under the following principles:

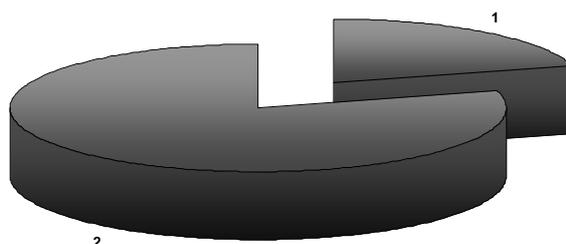
- insurance may cover the property connected with the execution of construction and assembly works,
- insurance may cover non-contractual public liability of a policyholder/the insured in relation to third parties due to the execution of construction and assembly works [18].

In particular „(...) TUiR Warta S.A. is not liable (in terms of public liability in tort) for: a) losses incurred as a result of a war, a state of emergency, a strike, riots, a rebellion, a revolution, an uprising, social and military unrest, a civil war, sabotage, a terrorist attack; b) losses incurred as a result of an intentional act or gross negligence of the policyholder or people acting in their name or on their behalf; c) losses incurred as a result of a nuclear reaction, radioactive contamination, contamination or pollution with industrial waste; d) losses due to partial or complete disruption in construction and assembly works because of any reason, except for the situation when it's caused by a loss covered by insurance; e) damages caused by vehicles which are subject to obligatory liability insurance, if an event which has resulted in a damage occurred outside the insured location, and damages caused by watercraft or aircraft; f) damages caused by infringement of copyright or granted licences and patents; g) losses in cash, securities, accounts, pay cards, documents, plans, archive collections and other collections of any kind; h) losses incurred by

employees of the policyholder or any other parties participating in construction and assembly; i) contractual penalties; j) fines imposed in administrative, court or disciplinary proceedings; k) losses caused by vibrations, subsidence or deterioration of load-bearing elements or bearing capacity of land (may be covered by insurance by including an additional clause); l) damages to property located on a construction site or in its immediate proximity, owned or held by an owner or administrator of a real property on which the works are carried out (may be covered by insurance by including an additional clause); m) damages leading to claims for compensation between individuals participating in the execution of construction and assembly works (may be covered by insurance by including an additional clause)”[19].

In the empirical research, the contractors responded to another very important question, i.e. if any of the listed insurers had ever refused to insure their construction and assembly works. The results of the research in this respect are shown in Fig. 2.

Figure 2: Insurance for construction and assembly works in activities of contractors surveyed



- 1 – an insurer refused to insure contractors' works (20.6% of the respondents)
2 – an insurer has never refused to provide an insurance service for contractors' construction and assembly works (79.4% of the respondents)

Source: prepared by the author on the basis of the replies given.

As can be seen in Fig. 2, 20.6% of the contractors have been refused insurance for their construction and assembly works by insurers. However, in the vast majority of cases, i.e. in case of as many as 79.4% of the respondents, they have never experienced such a refusal. Another interesting thing here are the reasons why some insurers have refused to provide their services to some contractors. In the survey questionnaires, almost all the contractors indicated too high risk as the main reason (as perceived by insurers) why they had refused to insure a given investment project. An example of such a risk, as indicated by two contractors taking part in the survey, was a high flood risk during the execution of the project. This is a specific type of risk but over the past few years it has been increasingly taken into consideration by insurers operating on the Polish market.

Conclusion

Both in theory and in practice, the problems of insurance used in the construction industry have been thoroughly discussed and analysed. This issue is broadly presented in the

professional literature all over the world; the examples may include the following publications: [20], [21], [22], [23], [24], [25], [26]. In particular, this applies to the use of insurance policies such as CAR and EAR in the construction industry [27]. „(...) In Poland a big number of contractors do not always take out CAR and EAR insurance policies. (...) Many contractors see CAR and EAR policies as unnecessary expenses, instead of treating them as an instrument which may be used to protect their businesses against potential risks”[17]. To sum up the research findings, it may be concluded that:

- contractors use services rendered by various insurers operating on the Polish market, in the area of construction and assembly insurance; every insurance carrier has a different offer in this respect, i.e. their offers differ, first of all, in terms of policy prices and general terms and conditions of insurance; 32.4% of the contractors tend to choose PZU S.A. as a ‘traditional’ insurer conducting their business on the Polish market;
- insurers sometimes refuse to provide their services to construction and assembly companies and don’t want to give them insurance cover for their construction and assembly activities, but only in case when a given project (as perceived by an insurer) carries a too high risk, e.g. there is a flood risk (in the research two contractors indicated such a risk).

Taking into account all the findings included in the paper, it should be emphasised that the knowledge of legal issues related to the use of insurance in the construction industry in Poland is of high significance. In particular, this concerns the legal structure of agreements concluded between contractual parties and insurers. The payment of a compensation is based on the provisions of an insurance contract signed by a given party. In other words, the wording of such a contract defines the grounds for payment of compensation to insured contractors. That is why it’s worth involving lawyers who specialise in such legal matters in an investment and construction process.

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