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Construction All Risks (CAR) Insurance and Advance Loss of Profits (Delay in Start-Up / DSU)

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On 27 October 2023, the Technical Engineering Committee of the Netherlands Insurance Exchange Association (VNAB) presented its 'Advance Loss of Profits' model clause (below: the 'model clause'). This is designed to align with the VNAB's earlier model policy known as the Dutch Insurance Exchange Policy for Construction and Assembly Works 2013 (below: 'NBBM'). The NBBM is a model or basic policy which – in short – makes it possible to insure against material damage to construction works. With the introduction of the Advance Loss of Profits model clause, the VNAB is making it possible to expand the coverage offered under the NBBM by also insuring loss of profits in addition to the material damage insured under this construction insurance.

1. Introduction

In this article, I will discuss the operation of this new model clause. For a proper understanding of the clause, it is worthwhile first discussing the background to the general characteristics of a construction insurance policy. An important condition to be met before loss of profits is compensated under the model clause is that the loss must be the result of material damage covered by the policy. This link is commonly made in the insurance market and is also used for other types of policies.

Before discussing the background to and operation of a construction insurance policy, I would point out that although the model clause has been given the title 'Advance Loss of Profits', the term more commonly used internationally is DSU (*Delay in Start-Up*): financial loss can occur as the result of a delay in the completion of a construction project.[1] It is this loss that is intended to be insured under a DSU clause.

After describing the background to construction insurance, I will discuss the system and content of the model clause. As far as that is concerned, it should be noted that the interpretation of insurance exchange conditions is mainly dependent on objective factors such as the wording of the provision, read in the light of the policy conditions as a whole and any accompanying explanatory notes. It should not be forgotten in this connection that existing views in a specific sector of the insurance exchange, such as in this case the technical insurance market, on the interpretation of a specific clause should

[1] The term *Advance Loss of Profit* is also abbreviated to ALOP.

also be taken into account when determining the extent of the policy cover.[2]

This article sets out to provide an overview.[3] My aim is to give the reader a broader understanding of the nature and operation of the model clause, which includes DSU under the insurance, a subject about which relatively little is known outside the technical insurance market.[4] As I cannot deal with this exhaustively here, I propose to concentrate on a few main aspects of the material scope of coverage by reference to the NBBM.[5]

2. CAR insurance at a glance

The NBBM is a *Construction All Risks insurance*, also known as CAR insurance. It is important to point out here that there is no standard policy with standard wording. Many different forms of policy with (textual) nuances in terms of coverage are available in the market. As already indicated, the VNAB has drawn up the NBBM. Moreover, leading brokers have drawn up sets of conditions that are regularly used when insuring construction risks. Naturally, there are also company policies. Nonetheless, a CAR policy has certain standard characteristics, and market parties sometimes choose to adhere to certain forms of wording used in the market or to explicitly derogate from them (in their own conditions or in clauses). For a proper understanding of a CAR policy and how certain more exotic provisions and coverages should be understood under such a policy, it is important to be aware of the standard characteristics of a CAR insurance.[6]

First of all, it is important to note that a CAR policy is construction insurance: it insures buildings and other structures. More specifically, such a policy covers, in principle, the interests of all persons involved in the construction project. The primary aim of the insurance is therefore to obviate discussions about who is liable for what damage. In complex construction projects with a main contractor, subcontractor and secondary contractors, this can be quite a puzzle. Such a discussion need not be conducted (or, at least, not to the same extent) if the issue of fault does not arise in relation to coverage of damage to the insured building. The intention of CAR insurance is to ensure that loss and damage can be settled quickly and that any discussion about liability does not hinder the progress of the construction project.

Unlike, say, a liability policy, the coverage under a CAR insurance policy takes effect as soon as there is *material* damage[7] to the insured object.[8] I will explain in more detail later exactly what is meant by this.

A CAR insurance therefore primarily provides coverage for material damage coverage: the object is insured, even if this means that the

[2] For the interpretation of insurance exchange policies, see, for example, Asser/Wansink, Van Tiggele & Salomons 7-IX 2019, no. 347.
[3] As regards the DSU clause, see also the informative brochure of the Dutch Association of Insurers of April 2017.
[4] For example, a search in a legal search engine for 'DSU', 'Delay in Start-Up', 'advance loss of profits' or similar insurance law terms yields no results or at least no useful results.
[5] It would be worthwhile comparing this with other products on the market, but this would be beyond the remit of this article.
[6] On this point, see also: T.J. Dorhout Mees, *De CAR-verzekering,* (R&P no. VR7a) 2019/1.2.
[7] Two similar terms are used in practice in Dutch for physical or material damage, namely 'materiële beschadiging' (used, for example, in the NBBM) and 'materiële schade'. In my opinion, these two terms are interchangeable and have the same meaning.
[8] Loss of property is also covered under a CAR policy. I will not go into this at greater length in this article.

indirect liability interests of construction parties are also insured.[9]

The second main characteristic of a CAR insurance is that it covers all risks. This means that, in principle, all risks are insured under it. For example, article 1.1 of section 1 of the NBBM provides as follows:

> '*During the construction/erection and testing periods, the insurance covers the damage suffered by an insured as a result of loss and/or material damage to all or part of the works, whether due to own fault, inherent defect or any other cause (...).*'

This coverage is broad as it is not subject to any additional conditions such as those associated with all risks coverage under property policies. In such cases, 'everything' is usually (also) covered, but the condition is that the damage must be the result of a 'sudden and unforeseen event' (or similar wording).

A CAR insurance therefore provides broad coverage. It follows that, for the purposes of coverage, it makes no difference whether work under construction burns down because a roofer has not worked in compliance with fire safety regulations or because a short circuit occurs in an installation. In principle, corrosion and gradual damage (for example, due to the use of incorrect materials) are also covered. The decisive factor is whether material damage has occurred. This means that establishing the legal cause of the damage is not particularly relevant in the case of a CAR insurance.[10] In his opinion of 27 June 1997 (NJ 1998, 329) drafted for the Supreme Court, Advocate General Hartkamp defined construction insurance as follows:

> *'a project insurance policy under which a dynamic process (implementing a construction project) is insured against all possible "failures".'*

Hartkamp's quote is illustrative, but not entirely accurate legally. The all-risks character does not actually mean that everything is covered. An important condition is the *material damage* to the works and there are also exclusions. For example, loss of profits is excluded from standard coverage. The observation that not everything is covered under a CAR insurance is relevant because it affects the scope of the DSU coverage (about which I will say more later).

An important limitation on the scope of the coverage provided under CAR insurance is inherent in the concept of material damage. According to settled case law, material damage occurs only if there has been an objective impairment of the material structure of the property which, according to commonly held views, characterises the material integrity of the property.[11] This therefore means that there must be (i) impairment of the material structure of the property, and (ii) the integrity of the property must have been impaired, this

[9] The purpose of such extensive coverage is apparent from the wide range of parties that are also insured under a CAR policy, for example the principal, contractors and main contractors, subcontractors, builders, construction site managers. All of them have an interest covered by the policy. By taking out a CAR policy, the policyholder, usually the main contractor or the principal, not only protects his own position but also that of his contractual counterparty and other parties involved in the construction project.

[10] I would add the caveat that this only applies in general. The exact wording of the policy must be examined in each case, and the cause of the damage may well prove relevant. Requirements may be laid down in specific forms of coverage (see, for example, the earthworks, road works and waterworks clause, also formulated within the framework of the VNAB and available for consultation on its website). Moreover, temporal limitations on the scope of coverage (such as the maintenance period) may be important, with the cause of the damage possibly playing an indirect role.

[11] This meaning of the concept of material damage is laid down in article 1.2 of the General Conditions of the 2013 NBBM. In my view, this is not intended to derogate from what is understood by it in case law.

being something which must be determined according to prevailing views.

To put it simply, if the concept of material damage is to be met, something must first have been broken. It is not sufficient that property has become less useable. And before an item of property can be broken, it must first have been in good condition. This too is something that can give rise to much discussion.

In the case law, the question of whether or not the process of carrying out part of the work was completed *before* a change in the material structure took place has been regularly discussed. Damage to property that occurred before completion is, in principle, not covered by a CAR policy.[12]

A third main characteristic of a CAR insurance is that is (or can be) an umbrella policy (i.e. a policy that combines several insurances in one). It can have multiple *sections*, which cover different risks and have different insured sums and deductibles.

Section 1 (the works) is of particular relevance to the model clause. This is a material damage section which covers the actual construction work that must be carried out (according to the construction specifications).

Section 2 (liability) is of less relevance for the purposes of this article. This section is intended to protect the construction parties against the claims of third parties.

A CAR insurance also usually contains a section 3 (existing property belonging to the principal). Like section 1 (the works), this is a material damage section. The existing property owned by the principal are insured under this category.

In addition, there are other categories, such as those for contractors' equipment and property belonging to the construction site managers and personnel. These are sections 4 and 5 in the case of the NBBM.

In practice, a (sixth) section is then added to insure against DSU damage. Such a section was included, for example, in the insurance in order to cover the risk of 'penalties' imposed by *Rijkswaterstaat* (the Directorate-General for Public Works and Water Management) in the event of late delivery under DBFM contracts. Such a penalty then constitutes a loss of profits for the project company. Furthermore, so-called 'acceleration costs', i.e. costs incurred by the builder in making extra efforts to limit or completely prevent any delay (i.e. by deploying extra equipment and personnel) are generally insured under the DSU coverage.

During its online presentation, the Technical Engineering Committee explained that there is now a need for DSU coverage, particularly in practice, because financiers of offshore wind farms demand coverage for delays in completion. DSU coverage provides lenders with additional comfort, since what are often shell project companies (known as Special

[12] See, for example, the judgment of The Hague Court of Appeal of 13 October 2020, ECLI:NL:GHDHA:2020:1844 in the case of Consilium Total Care v HDI), judicial consideration of law 3.6: '*The Court of Appeal is of the opinion that HDI has adduced sufficient evidence in these two reports to disprove that the damage occurred to a top layer that was (initially) intact. In essence, the reports state that the top layer was applied too thickly, as a result of which the solvents beneath the film layer could not evaporate sufficiently. This created little craters/pores/pinholes and the top layer came loose as a result of the compression forces. The fact that the top layer was applied too thickly is apparent from COT BV's examination of the paint flakes from the track itself. The samples were taken in early September 2015 from the parts of the track where blistering was occurring at that time. As this shows that the top layer was not intact at the start, there was no damage within the meaning of the CAR insurance.*

Purpose Vehicles or SPVs) may be used in construction projects of this kind.

The model clause provides a standard text for DSU coverage, from which the parties – as is the case with the NBBM – are naturally free to derogate. This brings me to the discussion of the model clause.

3. The model clause (DSU)

General

The purpose of the model clause is to add a sixth section to the NBBM, namely Section 6 'advance loss of profits', which adds coverage for damage due to delay in completion.

It is relevant here that loss of profits is excluded from standard coverage. I would refer to article 1.5, opening words and (e) of Section 1 (the works), which shows that the following are excluded:

> *'loss of profits' as well as costs incurred in preventing loss of profits, including costs resulting from delays in the works and in the execution and negotiation of contracts.'*

In the NBBM, *loss of profits* is defined as follows:

> *'Pecuniary loss consisting of the loss of net profit and the recurring overhead charges no longer offset by any income, as a consequence of business stagnation brought about by material damage and/or loss.'*[13]

The model clause provides for loss of profits in the form of *advance loss of profits* to be included under the policy, but exclusively for the benefit of the policyholder. See article 3.1 of Section 6:

> *'This Section covers the advance loss of profits incurred by the policyholder resulting from a delay and/or the extra costs resulting from or caused by one or more insured occurrence(s).'*

It follows that the model clause covers both advance loss of profits and extra costs.

Advance loss of profits

In article 2.7, *advance loss of profits* is defined as follows:

> *'(...) the aggregate of recurring overhead charges and projected net profit during the period by which completion of the insured contract works exceeds the Scheduled Completion Date and has a negative impact on the policyholder's planned business operations, as a result of one or more occurrence(s) insured under Section 1 of this policy.* (emphasis added).

In short, the aim of the model clause is to provide for insurance against loss of profits due to delayed completion. The loss of profits in question are those *actually incurred* by the insured interested party, i.e. the party that generates income from operating the deliverable after completion.

It is noteworthy that in the definition cited above, the coverage is linked to the 'insured occurrence(s)' under Section 1 (the works). It should be borne in mind that in the case of CAR insurance the cause of the damage is, in principle, not relevant and the actual intention is to insure the *material damage* to the work as an 'event'. That is the insured occurrence to which the model clause refers.

The attentive reader will undoubtedly have noticed in this context that the phrase 'insured

[13] See article A.V.1.4 of the 2013 NBBM.

occurrence' in article 2.7 is not capitalised. Based on a purely objective interpretation, it could be argued that this is intended to show that here the phrase does not have the meaning given to it in the definition of 'Insured Occurrence' in article 2.4 of the model clause. This article reads as follows:

> '*In the context of this Section an Insured Occurrence is understood to mean a loss occurrence within the Territorial Limits as defined in this Section, which is covered under Section 1 of this insurance during the construction/erection and/or testing period(s), even if such loss does not exceed the applicable deductible under Section 1 or is not compensated under Section 1 because it is (partly) recoverable under a warranty obligation.*' (emphasis added).

It seems to me that this is a typographical error which the drafters of the model clause will undoubtedly correct, and that they must have intended the definition in article 2.4 to apply to article 2.7. It would be advisable to correct this as the possibility cannot otherwise be excluded that a court might apply an objective interpretation and not adhere to the definition of insured occurrence in article 2.4.

Extra costs

As indicated in Section 6 – in addition to advance loss of profits – extra costs are also insured. These are the following costs:

> '*The extra costs the policyholder will actually incur in consultation with insurers (including the costs resulting from article 8.2 of this Section) in order to minimise or prevent the Expected Delay, even if in retrospect these costs turn out not to have been useful or effective. All this on condition that the aggregate of these extra costs does not exceed the amount by which they are expected to reduce the Advance Loss of Profits borne by insurers. (...)*' (emphasis added).

In short, the acceleration costs are insured. However, it is important to note that these costs should be incurred in consultation with the insurers.[14] It goes without saying that – just as in the case of loss mitigation – there is no guarantee in advance that an acceleration measure will actually have an effect, so that – as reflected in the text – it does not matter for the coverage of the costs incurred whether the measures do actually help to limit or prevent the delay.

For the record, I would point out that the definition of 'Extra Costs' in article 2.2 includes a number of coverage restrictions. For example, it provides that the compensation for extra costs may not exceed the amount by which the measures *are expected* to reduce the Advance Loss of Profits borne by the insurers.[15] Although this seems to create uncertainty, there is unlikely to be a problem in practice since the measures must be coordinated in advance. One factor that will undoubtedly be taken into account in those consultations is the extent to which the measures are in the interests of the insurers and/or the insured. Another matter that it is advisable to coordinate at that time is to what extent the costs will be reimbursed under the policy. The

[14] The question arises of whether there is a right to have acceleration costs compensated if the costs have not been incurred in consultation with the insurers. This discussion is in some ways similar to (albeit not entirely the same as) the issue in liability insurance as to whether an insured is entitled to the costs of legal assistance if they have been incurred without the approval of the insurers. See, for example, J.H. Wansink in: *Verzekering ter beurze. Coassurantie in theorie en praktijk*, O&R no. 67, 2017, no. XVII.5.2.

[15] In my view, this is a permissible restriction on the scope of the coverage offered.

provision seems to be primarily intended to clarify the compensation framework between the parties *in advance* and, in my view, it would be better to include this in a different part of the model clause than to 'conceal' it in this way in the definition.

The definition also contains an allocation provision which is relevant to the scope of the coverage offered:

> '*If extra costs have been incurred to minimise both the Advance Loss of Profits and the Waiting Period, these costs will be reimbursed by insurers on a pro rata basis.*'

The background to this is that acceleration measures can be in the interests of both the insurers and the insured. After all, the insured has a deductible under DSU coverage as well. In this case, it is expressed in the form of a waiting period (see article 2.11), i.e. a period specified in the policy schedule (in working days) within which the delay in completion remains at the expense of the policyholder. The payment period starts only after the waiting period has expired (see article 2.8). In short, this means that if, say, the waiting period is 30 days and the total delay of 45 days is reduced by 30 days, the acceleration measures have been 50% in the interests of the insured and 50% in the interests of the insurers. In practice, the situation is likely to be more complicated.

Here too, there is an analogy with loss mitigation measures. In the context of loss mitigation, the measures taken can serve both insured and uninsured interests. In such a situation, a pro rata approach is usually adopted.[16] Although arguments can also be made for a different approach, the pro rata approach seems to me to ensure a correct and fair distribution of the costs of acceleration measures between the insured and the insurers.

Exclusions

Apart from the coverage restrictions inherent in the system of the model clause (see part 4 below), article 6 of the model clause contains a number of exclusions. This provides for the exclusion of coverage for delays caused by or resulting from, for example, unavailability of sufficient financial resources to the policyholder or the inaccessibility of the construction site. Article 6.7 also contains an exclusion for improvements to the original method by which the work was carried out. Strictly speaking, this article is, in my view, superfluous since this already follows from the system of the coverage.

The exclusion of penalties recoverable by the policyholder from contractors/suppliers deserves separate attention. The opening words of article 6 in conjunction with article 6.4 of the model clause read as follows:

> '*No cover is provided under this Section for and/or excluded from this Section are the Advance Loss of Profits and/or Extra Costs and/or effect of the Delay caused by or resulting from: (...) penalties and similar amounts the policyholder can recover from contractors/suppliers due to non- or delayed completion of the insured contract works*.' (emphasis added).

According to a textual interpretation, the exclusion applies only to delays caused by or resulting from recoverable penalties. That is hard to imagine. As also discussed during the

[16] See T.J. Dorhout Mees, *De CAR-verzekering*, (R&P no. VR7a) 2019, p. 488. Cf. also the judgment of The Hague Court of Appeal of 11 October 2016, ECLI:NL:GHDHA:2016:282 as regards defence costs.

online presentation, the intention is presumably to make the coverage *secondary* to penalties recoverable from contractors/suppliers. Here, it seems to me that the drafters of the model clause still have some work to do in order to streamline the text of the provision and bring it into line with the intention of the Technical Engineering Committee. If the current text is maintained, it is not inconceivable that recoverable penalties will be insured under the policy. After all, as the explanation given during the online presentation is not part of the written explanatory notes to the model clause, there is a risk that a court may allow the text of the exclusion to prevail

4. The relationship between the DSU coverage and Section 1 (the works)

As indicated, the DSU coverage is linked to the coverage for material damage to the works. This is an important basis when determining the scope of the DSU coverage.

The explanatory notes to the model clause (see page 6 of the model clause) state in this connection:

> '*As cover under this Section is only effective following an insured claim under Section 1, any limitations in the cover under Section 1 or the general conditions will also have an impact on the cover under this Section*.'

As is apparent from these explanatory notes and the definition of Insured Occurrence (article 2.4), advance loss of profits is insured only if the delay is caused by material damage covered under Section 1. That is the 'impact' to which the explanatory notes refer. The information document on DSU coverage drawn up by the Dutch Association of Insurers puts this even more plainly:

> *'Only damage covered by the CAR insurance can lead to a claim for coverage under the DSU insurance. Generally, DSU insurance is only taken out for a specific project. The DSU coverage is, in principle, linked to the coverage under Section I of the CAR policy, 'The works'. A link between DSU and other sections is possible, but requires a further risk assessment.*
>
> *The scope of the policy coverage for each separate section implicitly determines the DSU coverage.'*

It should be noted that completion delays can also be caused by *non*-insured circumstances. Examples are delays in the delivery of materials due to external circumstances (a war or a crisis such as the Covid 19 pandemic) or the discovery, in the event of damage, that a design error[17] necessitates a redesign (delay) and/or a different method of implementation

[17] It should be noted that the financial loss incurred as a result of redesign and/or a different method of implementation is not covered under the material damage section. On this point, see T.J. Dorhout Mees, De CAR-verzekering, (R&P no. VR7a) 2019, p. 167: *'If the design error was discovered in time before it could cause damage, there will certainly be damage as a result of a design error. Undoubtedly, adjustments necessitating certain costs will have to be made, but no cover exists because no event within the meaning of the policy, i.e. damage, has occurred (...)'.*

Moreover, the discovery of a design error can lead to a situation in which there is an immediate threat of material damage covered under the material damage section (the works). On this point, see T.J. Dorhout Mees, *De CAR-verzekering,* (R&P no. VR7a) 2019, p. A489, gives the example of a wall that is on the point of collapse and needs to be buttressed. In my opinion, he rightly distinguishes between the purely factual costs incurred in order to avert the imminent disaster (the costs of the buttressing measures), which are eligible for compensation, and the uninsured (subsequent) costs of demolishing the wall (assuming that demolition is not the most appropriate way to avert the imminent disaster).

In keeping with this approach, the costs of redesign and/or a different method of implementation are also not eligible for compensation. I would point out in this connection that since the Supreme Court's judgment in the

(delay).

For these and other 'uninsured occurrences', DSU coverage does not provide compensation. The reasoning behind this is clearly that the insured should not be able to shift his business risk to his insurer. Claims can be made under DSU coverage only in so far as there is material damage covered under the works section. This is usually also the case with PDBI insurance and machinery damage (and business interruption) insurance.

The above means that, in principle, DSU coverage mirrors the coverage under the material damage section (the works). For example, suppose that the CAR policy does not provide coverage under that section for the costs incurred in making improvements to the design,[18] there is then no coverage either under the DSU section for delays resulting from the making of those improvements. This also means that delays caused by damage to an object that was not 'right' in the first place are not covered by the DSU insurance.

See also the information document of the Dutch Association of Insurers (p. 7):

'2.8 Is everything insured?

As with any insurance, exclusions also apply in the case of DSU. First, all exclusions and limitations that apply to CAR also apply to DSU.

Common exclusions are delay due to:

(...)
- *changes, adjustments and improvements and repair of other deficiencies that are carried out after the insured event has occurred;*

(...)' (emphasis added).

It follows that although the text of the clause is not particularly extensive in terms of the amount of text, the scope of the DSU coverage is largely determined by limitations in the scope of the coverage under Section 1 (the works). These limitations can result from textual limitations in the scope of the coverage under Section 1, but also from inherent – more implicit – limitations related to what is understood by material damage in a CAR policy and the nature of the coverage provided in this regard.

In consequence, determining the damage covered under the DSU section is quite complex. The key with DSU coverage is to be able to distinguish what part of the delay is due to insured material damage and what part to uninsured interests.

A difficult comparison has to be made here: what would the completion date of the work have been without the insured damage?

Finally, I would point out that it follows from the text of the model clause that a delay caused by material damage that is admittedly insured but *does not exceed* the deductible of Section 1 is insured under the DSU coverage.[19] This has

Asbestos Roofs case (ECLI:NL:HR:2022:588) there has been a good deal of discussion about the doctrine of loss mitigation. I will not delve into this in this article, but suffice it to say that – regardless of whether the approach taken by the Supreme Court was correct – the judgment cannot, in my opinion, be applied one-to-one to a loss mitigation situation under a CAR policy.

[18] In the insurance market, such improvements and, for example, a change in working method are not usually covered under the material damage section (the works) of the CAR policy. In the case of the NBBM, this is stated explicitly in article 1.5 (d) of the 2013 NBBM.

[19] See the wording in article 2.4: '*even if such loss does not exceed the applicable deductible under Section 1 or is not*

the advantage for the insured that a *major* delay caused by only *minor* material damage is insured under the DSU coverage.

5. Conclusion

It is to be welcomed that the VNAB's Technical Engineering Committee has developed a model clause for DSU coverage. This will increase awareness of this relatively unknown coverage. As is apparent from the above, the text of the model clause is not particularly extensive, but the complexity of determining the damage covered under the DSU category is almost inversely proportional, given the 'concurrence' of insured and uninsured delay and the link with the requirement of material damage. As the drafters of the model clause have also indicated, it is important to note that the model clause does not provide a solution for all possible aspects relevant to DSU coverage. In this respect, a tailored approach is and remains necessary for DSU coverage, with a role for the broker.

It would be beyond the scope of this article to discuss all relevant aspects. For example, the issue of DSU coverage in relation to Section 3 can still be explored (in the case of an extension to systems/buildings) and the role of the risk controller in DSU projects also needs to be considered. In this respect, this article can be regarded as an acceleration measure to make up for delays in this area.

compensated under Section 1 because it is (partly) recoverable under a warranty obligation'.