What Does “Fit For Purpose” Mean?

What does “fit for purpose” mean? Why is this phrase such a thorny issue when negotiating construction contracts? Should a design and construct contractor worry about agreeing to an obligation that the works need to be fit for purpose? What about an employer? Should an employer insist on such an obligation? Are there insurance implications?

A fit for purpose obligation in a construction contract simply means the contractor agrees that the design will meet the employer’s demands. The employer’s requirements may be set out in great detail or they may be intentionally broad. The bottom line is that an employer need only prove that something does not work as intended (by reference to an intent expressed in the contract) to show the obligation has been breached. The employer does not need to prove negligence or meet some other fault-based test. So, it is obvious why an employer will typically want a fit for purpose obligation expressed in the widest terms achievable.

An obligation to design something for a construction or engineering project so it will be fit for purpose when completed is a tough obligation. It is a tougher obligation than a duty to design using reasonable skill and care, which is the obligation that a consultant will normally assume under a design consultancy arrangement. For a designer to fall foul of a reasonable skill and care obligation, an employer has to show that the designer has been negligent, i.e. the design does not meet the standard expected of a professional engineer exercising reasonable skill and care. This is a difficult test for an employer to meet.

Dual design and construction obligations

What about where a contractor is engaged to perform both the design and construction roles? In large construction and engineering projects, it is common to see the contractor engaged as both the designer and the constructor. The contract documenting this arrangement is usually based on an international standard form of construction contract. In the Middle East, the most popular standards stem from the FIDIC family of contracts. These include the Yellow Book for Plant Design and Build and the Silver book for Turnkey (often project finance) projects. In their unaltered form, both of these standard documents contain an express obligation that the “Works shall be fit for the purposes for which the Works are intended as defined in the Contract”.

Let us consider, for example, an EPC contract for a power plant. The contractor will normally guarantee that, on completion, the power plant will achieve certain performance standards such as net power output and net heat rate. Guarantees of this nature are synonymous with fit for purpose obligations. These guarantees will usually be the employer’s key statement of purpose and failure to meet them will result in a claim for breach of the guarantee. Therefore it is debatable whether a separate “fit for purpose” obligation is needed to be expressed where there are express comprehensive performance guarantees.

What the contractor needs to be clear about is the employer’s statement of purpose. The contractor will be looking for narrowly defined purposes, rather than functional statements that could be interpreted as covering a large range of purposes. The Yellow and Silver Book standard wording does provide that the fit for purpose obligation is to be matched against the intended purpose stated in the contract, rather than simply fit for purpose without any benchmark. The challenge for the contractor will be to clearly identify where the statements of purpose are in the contract and ensure that they are as specifically and narrowly defined as possible.

Are there PI Insurance implications?

The discussion about fitness for purpose in a contract negotiation has a lot to do with insurance. Most PI policies contain an exclusion in relation to any fit for purpose obligations. It is not hard to see why the contractor (who is also the designer) will be resistant to the contract containing express fit for purpose wording.

The courts will look at the substance of an obligation rather than the particular wording used when deciding whether it falls within the fit for purpose exclusion in the insurance policy. For example, the exclusion may still apply where the words “fit for purpose” are deleted from a contract, if an obligation to comply with the employer’s demands remains and these demands include suitability for particular purposes.

A contractor will need to be clear about what its insurance will cover and how it is going to manage excluded risks. If it looks as if the contractor will have to assume this risk to win the work, the contractor may be able to trade the
assumption of this risk for other compromises given by the employer at the negotiating table.