

A photograph of two industrial workers in a factory. In the foreground, a man with a beard, wearing a yellow hard hat, safety glasses, and a dark blue work jacket with reflective silver stripes, is focused on a task. He is wearing white gloves and holding a tool. In the background, another worker in a yellow hard hat and safety glasses is partially visible, working on a different part of the machinery. The machinery is large, metallic, and appears to be part of a manufacturing process.

SEPTEMBER 2025

Casualty Bulletin

Insights from Crawford Specialist
Liability Services



On the money — financial loss extensions

Within the context of liability claims and public and product liability insurance, where the intention of the policy is to indemnify the policyholder for liability arising in tort and any concurrent contractual liability, it is generally accepted that *financial loss* must be consequent upon physical damage to third party property.

Any losses not consequent upon damage are known as *pure economic loss* and would not generally be recoverable in tort. As such, *pure economic loss* would not trigger the operative clause of a standard policy. However, in such cases, an appropriately worded Financial Loss Extension may provide additional coverage.

A full analysis of the position in the complex area of Financial Loss Extensions is beyond the intention of this article. However, we have sought here to provide a brief overview of the potential assistance available and typical barriers to cover to assist insurers, policy holders and other stakeholders.



PURE ECONOMIC LOSS

These are financial losses incurred by a third-party claimant following an incident, albeit absent any physical damage to that third party's property.

It is first sensible to recap on what exactly *pure economic loss* is.

A good example might be the insured contractor excavating a highway and damaging electricity cables, which consequently disrupted the power to surrounding businesses who, as a result, incurred down time and loss of business.

Such losses would be considered purely economic and thus not recoverable in tort against the tortfeasor. However, any loss of profits caused by physical damage to products within said affected businesses, which is not considered too remote, might be recoverable (*Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd*).

This is notwithstanding the involved discussion around what exactly constitutes damage, which has seen the Courts go back and forth in their position on the matter (an issue that could form an entire article in itself). The debate is particularly relevant in relation to product liability claims and construction disputes where, for instance, the product supplied, or structure built, is deemed defective.

Courts have held such damage to be purely economic in nature; however, this is highly nuanced and there are varying cases which discuss this hotly debated topic. *Bacardi-Martini Beverages Ltd v Thomas Hardy Packaging Ltd* being one of the more controversial, which held that a defective ingredient did not cause damage to the end product but rather created a new defective product, thus amounting to *pure economic loss*.

There are, of course, exceptions to this general rule about recoverability of pure economic loss in tort, specifically in relation to negligent advice or statements, as seen in *Hedley Byrne v Heller*. Here, it was held that such losses could be recoverable in tort where a special relationship exists between the parties, although such scenarios would generally fall under a professional indemnity policy and are usually outside the scope of a public liability policy, which typically requires “damage” to trigger cover.

The main intention of public and product liability cover is to indemnify the insured for their liability arising to the public at large (i.e. in tort and, usually, any concurrent contractual and/or statutory liability alongside). There are, however, situations where a business becomes contractually liable above and beyond what their tortious liability would be, such as in situations involving *pure economic loss*, or otherwise seen as contractual liability absent of damage.

Liability policies will therefore usually seek to control to what extent they provide cover for such contractual liabilities; usually within the wording of the operative clause and/or with the use of contractual liability exclusions.



The precise wording of a public or product liability operative clause can determine the extent of cover.

For instance, take a scenario where a third-party business has lost future orders as a result of a defective product supplied by a defendant policyholder. Linking words such as *in respect of*, which we commonly see, have been held in numerous cases to be quite restrictive and relate solely to losses directly caused by the physical loss.

Contrast this, however, with linking words such as *arising out of* or *accompanied by*, which have been held to be potentially far wider in scope and conceivably encompass future loss of orders. It is therefore evident that an element of financial loss cover can be inherent within the main policy cover, subject to wording.

An insurer may also provide additional cover for these losses with the addition of a Financial Loss Extension. It is unsurprising when looking at individual Financial Loss Extensions that, following what has already been discussed, there is a wide variation of wordings used.

Extensions can range from wide reaching cover to almost none. In fact, despite the primary way in which such losses arise, some Financial Loss Extensions attempt to exclude contractual liability altogether, prompting the question as to what cover the extension provides. These types of extensions became popular in the 1980s and followed the decision in *Junior Books v Veitchi*.

Junior Books allowed for the recovery of pure economic loss in tort and saw the introduction of “tort only” Financial Loss Extensions which, by their very nature, provided no contractual liability cover. The law within the UK has, however, moved away from this decision and, arguably, so too should have the insurance market writing those extensions. There are nonetheless still such extensions being provided and it is for parties seeking/advising upon enhanced covers to help ensure business needs are being met.





In contrast to the aforementioned tort only covers, there are today a wide variety of Financial Loss Extensions which do provide significant contractual and other covers, sometimes with very little restriction.

An example of a Financial Loss Extension can be seen below:

*Notwithstanding Exclusion 2.5.9 – Financial Loss, the **Insurer** will provide indemnity to the **Insured**:*

*a) against legal liability for **Damages** in respect of claims for **Financial Loss** caused in connection with the **Business**:*

*b) for **Defence Costs** of any claim against the **Insured** which is covered (or if is upheld would be covered) under Clause (a) above.*

As with any insurance policy, the devil is in the detail. It is paramount that any party seeking or advising upon such cover reviews the policy wording in depth and, if in doubt, seeks a well versed professional to assist.

Financial Loss Extensions can, unlike most public and product liability policies, which are typically written on an “occurrence” basis, be written on a “claims made” basis, in much the same way as, for example, professional indemnity or product recall policies.

The wording of Financial Loss Extensions can vary widely, both in the context of the operative clauses and the exclusions. Similarities are sometimes encountered (notably the application larger excesses versus the standard liability cover) but, typically, the intentions of any two extensions can be quite different.

Crucially, the extent of cover will be contained within the wording and it is paramount that the professional tasked with interpreting the policy is au fait with the impact that the specific use of words might have.

The example wording provided is fairly standard in its approach and does not immediately look to limit cover to loss in tort only/ exclude pure contractual liability. Naturally, the definitions will need to be reviewed and, in this regard, what is meant by Financial Loss, which will usually be a pecuniary loss absent of physical damage; in line with what constitutes pure economic loss.

After reviewing the insuring/ operative clause, it is then necessary to consider the exclusions contained within the extension. This is particularly relevant as a Financial Loss Extension is usually written on an “all risks” basis (i.e. every eventuality is covered unless expressly excluded), although this will vary policy to policy.

The following is by no means an exhaustive list but provides examples of typical exclusions found:

1. Risks covered under the General Liability policy
2. Risks covered under other available covers
3. Contractual liability
4. Intentional acts
5. Business or enterprise risks
6. The retro date and known claims/ circumstances
7. Geographical limits
8. Other risks

Turning to the example extension included, the following exclusions are noted:

The indemnity in this extension will not apply to legal liability or pay any amounts arising out of or in connection with:

- i. *any breach of professional duty.*
- ii. *the design, planning or supervision of building or construction works; and any testing or advisory activity arising out of or in connection with these.*
- iii. *advice or assistance given for the design, planning or introduction of data processing or automation systems.*
- iv. *the effecting or maintenance of insurance.*
- v. *(the handling of money, accounting, provision of finance, or advice on financial matters.*
- vi. *the estimation of construction costs, manufacturing costs or any other costs.*
- vii. *failure to observe agreed contract periods, to comply with agreed delivery times or non-completion or delay in performance of a contract.*
- viii. *strikes or labour disputes.*
- ix. *financial default or insolvency of the **Insured** or any other person.*
- x. *any libel or slander, deceit, injurious falsehood, passing off or infringement of patent, copyright, design rights, registered or unregistered trademark or trade name, fraudulent, dishonest or unauthorised use of systems or programmes of others; or breach or alleged breach of anti-trust law, competition laws or regulations.*
- xi. *any breach of trust, breach of warranty of authority or breach of duty owed to shareholders, investors, partners or any other party other than the **Insured** by any director, partner or officer of the **Insured**.*
- xii. *any loss or costs incurred by a statutory authority in enforcing statutory requirements or carrying out statutory duties.*
- xiii. *any claims made against any one **Insured** by any other **Insured**.*
- xiv. *any **Event** which commenced prior to the **Retroactive Date**.*

We do not propose to dissect the example in depth, however, it is clear there is no exclusion for contractual liability here, which, as discussed, one would hope to be the case in any meaningful Financial Loss Extension. The reader will note that there are many exclusions seen here where a particular risk should be covered elsewhere, such as under a professional indemnity or D&O policy.



In summary, this area of insurance and law is complex. It is imperative that professionals dealing with liability claims are familiar with the legal framework surrounding pure economic loss, the potential barriers to cover under standard liability policies and the assistance (or not) available under the various Financial Loss Extensions available in the market.

The law is an ever-evolving landscape and the position may change again but, by utilising experts that deal with these policies regularly and keep abreast of developments, the parties involved stand an improved chance of understanding their position at the earliest opportunity. Expert involvement from the outset serves the insurer's and insured's interests, whereby the correct decision can be reached at the earliest opportunity and expectations can be managed.

About the author

As Head of Executive Adjusting in Crawford Specialist Liability Services, Steve is responsible for operational matters and direction of the team, as well as conducting the highest value and most complex liability losses both domestically and internationally.

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