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Constructive Notes®

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Policy Triggers in Construction Liability Insurance

by Patrick Mead, Partner

Generally the policy trigger in construction liability insurance will be that there is:

1. A legal liability to pay "Compensation";
2. In respect of personal injury or "Property Damage";
3. As a result of an "Occurrence".

Ordinarily "Compensation", "Property Damage" and "Occurrence" will be defined terms within the Policy as follows:

> ***"Compensation"*** *means monies paid or agreed to be paid by judgement or settlement.*
>
> ***"Property Damage"*** [the meaning of which will often also be the trigger for policy response under contract works policies and which will be considered in the next edition of Constructive Notes] *includes:*
>
> > *Physical injury to a loss of or destruction of tangible property (often with a loss of use component).*
>
> ***"Occurrence"*** *is an event which results during the period of insurance in (personal injury) or Property Damage.*

In Brief

§ In the first of a two part article, policy triggers in construction liability insurance are analysed having regard to recent case authorities.

Patrick Mead, Partner

Compensation

In *Yorkshire Water Services v Sun Alliance & London Insurance PLCC* it was said ([1997] 2 Lloyds Law Rep 21, by Stuart-Smith LJ (Waite LJ agreeing) at 28-29):

> *"In my judgment Mr Crowther's analysis is correct when he submits that there are four steps leading to a claim under the prudential policy. 1. the original cause; 2. an occurrence arising from the original cause, which is relevant to the limits of liability; 3. claims made by third parties in respect of damage to property; 4. the establishment of legal liability to pay damages or compensation in respect of such sums.*
>
> *Or to put it another way there are four relevant requirements before an indemnity can be obtained under the policy. 1. Sums 2. which the insured shall become legally liable to pay 3. as damages or compensation 4. in respect of loss or damage to property.*
>
> *In this context "sums" must mean sums paid or payable to third party claimants. No such sum arises in relation to the flood alleviation works. "Legally liable to pay" must obviously involve payment to a third party claimant and not expenses incurred by the insured in carrying out works on his land or paying contractors to do so. And the liability must be to pay damages or compensation. "Damages" means sums which fall to be paid by reason of some breach of duty or obligation." See Hall Brothers Steamship Co. Ltd v Young, [1939] 63 L1.L. Rep. 143 at p. 145. "Loss or damage to property" is a reference to the property of the third party claimant and not that of the insured.*
>
> *Mr Crowther relied on the cases of Post Office v Norwich Union Fire Insurance Society, [1967] 1 Lloyd's Rep. 216; [1967] 2 Q.B. 363 and Bradley v Eagle Star Insurance Co Ltd [1989] 1 Lloyd's Rep. 465; [1989] 1 A.C. 957 in which the Post Office case was affirmed. Both cases were concerned with claims where the plaintiff was suing the tortfeasor's insurer direct under the Third Parties (Rights against Insurers) Act, 1930 and involved the question of what had to be established before the insured tortfeasor had a right to sue the insurer.*
>
> *Lord Denning M.R. in the Post Office case said at p. 219, coll. 1; p. 373F:*
>
> > *…so far as the "liability" of the insured person is concerned, there is no doubt that his liability to the injured person arises at the time of the accident, when negligence and damage coincide. But the "rights" of the insured person against the insurers do not arise at that time. The policy says that "the company will indemnify the insured against all sums which the insured shall become legally liable to pay as compensation in respect of loss of or damage to property". It seems to me that the insured only*

acquires a right to sue for the money when his liability to the injured person has been established so as to give rise to a right of indemnity. His liability to the injured person must be ascertained and determined to exist, either by judgment of the court or by an award in arbitration or by agreement. Until that is done, the right to an indemnity does not arise. I agree with the statement by Devlin J. in West Wake Price & Co. v Ching –

… the assured cannot recover anything under the main clause or make claim against the underwriters until they have been found liable and so sustained a loss…

This passage was expressly approved in the House of Lords in Bradley's case. It is subject to the gloss that the insured is entitled to sue for a declaration that the insurer will be liable to indemnify him, if this is disputed, before payment is actually made. And the contract can be specifically enforced so that the insurer can be obliged to pay, (unless there is a "Pay to be paid" clause) without the insured actually having to pay first; but the liability to pay quantified sums must be established. See per Lord Goff or Chieveley in Firma C-Trade Ltd v Newcastle Protection and Indemnity Association Ltd [1990] 2 Lloyd's Rep 191 at p. 202; [1990] 2 All E.R. 705 at p.717."

The conclusion detailed by those authorities is that the insured has no entitlement to indemnity prior to the legal liability to a third party being established.

Scope for Implication of a Term

Policies often contain a mitigation clause requiring a party to take steps to avert or minimise the possibility of further loss. Often this obligation is one imposed as a purported precondition to policy coverage and, in rare circumstances there may in fact be an express right given to the insured to recover from the insurer amounts expended in mitigating its exposure. (In the absence of an express right to payment, the mere fact that an obligation is imposed on one party to a contract for the benefit of the other does not of itself carry an implied term that there is an entitlement to reimbursement of the costs incurred: *Royal Sun Alliance Insurance (Australia) Ltd v Mihailoff* [2002] SASC 32).

An issue that sometimes arises is whether, in the absence of a "mitigation" clause, it is open for an insured which has incurred expenditure in order to mitigate a liability to a third party (which would otherwise have been covered under a policy) to claim their costs directly against the insurer on the basis of an implied term in the policy.

In a case of *Yorkshire Water Services Ltd v Sun Alliance & London Insurance PLC* [1997] 2 Lloyd's Rep 21, unanimously the trial judge and Court of Appeal rejected the claim for the implication of such a term. Stuart-Smith LJ stated that one of the reasons for rejecting such an implication was that it was not necessary to imply any such term to give business efficacy to the liability policy in that case (at 30). Stuart-Smith LJ also pointed out (at 28) that it is a fallacy to elevate the "Occurrence" in a liability policy to the "peril" insured against: It is the insured's legal liability to pay compensation that is the "peril"..

In *Yorkshire Water*, the insured operated a sewage sludge waste tip on the banks of the river Colne. There was an accidental failure of the tip, causing a vast quantity of sewage to be deposited in the river and into the sewage works. In order to avert further damage to the property of others and to prevent or reduce the possibility of claims similar to those made against the insured by a third party the plaintiff spent a large sum of money doing urgent flood alleviation works on its property. The plaintiff claimed the cost of the remedial works under liability policies under which it was an insured. It asserted an implied term that:

(a) *"Every contract of insurance carries an implied term that the insured will make reasonable efforts to prevent or minimise loss which may fall to the insurer. If such precaution or mitigation involves the insured in expenditure, it is an implied term … that the insured is entitled to be indemnified in respect of that expenditure"; or*

(b) *"The insured is entitled to be indemnified (up to the limit of the policies) in respect of expenditure reasonably incurred to prevent or minimise further loss which may otherwise fall to the insurer consequent on the occurrence or event."*

The trial judge and the Court of Appeal rejected the claim.

Reference should also be made to *Guardian Assurance Co Ltd v Underwood Constructions Pty Ltd* [1974] 48 ALJR 307. In that case the High Court allowed recovery under a policy of insurance for the insured's costs of repairing uninsured items outside of an excavation which had been damaged. The court held that in circumstances where the insured's excavation had been damaged and the repair of those uninsured items was necessary to restore the insured excavation to its undamaged condition, that those costs should be recoverable as loss or damage to the insured excavation. The evidence in that case established that the damage to the office block disturbed the physical integrity and enduring quality of the excavation itself, which in the absence of repairs undertaken were susceptible to further collapse. The High Court however decided the case solely on the ground that the costs were recoverable because they were incurred to restore the already damaged insured excavation.

Re Mining Technologies Australia Pty Ltd [1997] QdR 60 concerned a property damage policy, under which the insurer agreed to indemnify a mining company against accidental "loss, damage or liability to" its underground mining equipment. That equipment was buried by a roof fall, as a result of which some of it was permanently lost. Some equipment was recovered by the insured. The insured's expenses of the successful recovery were far less than the insured value of the equipment. It was held by majority (Davies JA and McPherson JA, Pincus JA dissenting) that the insured was entitled to indemnity against those expenses.

The decision was concisely summarised by de Jersey CJ (Jerrard JA and White J agreeing) in *PMB Australia Ltd v MMI General Insurance Ltd* [2002] QCA 361; 12 ANZ Ins Cas 61-537 at [25] – [26] in the following terms:

> *"[25] … a condition of the contract of insurance … obliged the appellant to 'take all reasonable precautions to prevent loss, destruction or damage to the property insured by (the) policy' … While not in terms apt to deal with the extended risk, the provision is not dissimilar from that from which Davies JA, in Mining Technologies, was prepared to imply the requisite term. … Davies JA was the only member of the Court prepared to do so. That said, the verbiage of the term Davies JA, proposed itself indicates the inappropriateness of making such an implication here. The term His Honour proposed reads (p 72):*
>
> > *'Where loss, damage or liability, which would otherwise have occurred, is avoided by the exercise of reasonable care, including the reasonable expenditure of money or performance of work, on the part of the insured or any person acting on the insured's behalf, that expenditure or the value of that work …'*
>
> *The loss or damage sought to be avoided by the 'new awareness' based expenditure here was not in that sense certain to occur.*
>
> *[26] Insofar as the other members of the court touched on the issue, McPherson JA referred (p88) to 'authority that expenses incurred in averting or warding off the imminent happening of the insured risk or peril are capable of being considered within the indemnity of the cover afforded against the loss itself', and Pincus JA was (p67) prepared to contemplate an implication to cover 'extraordinary' expenditure to avoid 'imminent damage'. Those featured do not characterise this case."*

The effect of the majority judgements is uncertain because the Judges in the majority gave different rationales for the result.

McPherson JA [at 84] relied upon the conclusion that it "was not a case where the loss was merely apprehended or the peril had not yet begun to operate. The equipment was already trapped or stranded in the tunnel by the collapse of the roof before the expense was incurred. The expenditure … was necessary in order to retrieve (the equipment) from an event or loss which had already happened."

McPherson JA also relied upon *Guardian Assurance Co Ltd v Underwood Constructions Pty Ltd*[1974] 48 ALJR 207.

His Honour's reasons were not however adopted by Davies JA – nor was his Honour referred to the *Yorkshire Water Services Case* (see also Pincus JA's analysis of *Guardian* at 65-66). Ultimately his Honour concluded that the process of retrieving the trapped equipment was one of "*repair"* within the partial loss provisions of the Policy.

Davies JA's finding of an implied term in *Re Mining Technologies* turned upon the nature of the policy and the facts of that case. His Honour found that retrieval of the equipment did not constitute repair, but his Honour was prepared to imply a term that provided for indemnity only in respect of expenditure incurred which avoided the occurrence of loss or damage.

Occurrence

A critical issue in determining policy response is the requirement that there be a relevant "Occurrence" during the period of insurance. When an "Occurrence" is said to arise in the context of a liability policy – specifically whether a relevant "Occurrence" took place prior to the expiration of a maintenance/defects liability period (the relevant period of cover) under a policy of insurance, was considered in the matter before the Queensland Court of Appeal in *Windsurf Pty Ltd v HIH Casualty and General Insurance Ltd* [appeal No 2380 of 1999].

In that case, the appellant was the developer of units at Runaway Bay and claimed to be entitled to be indemnified under its insurance contract with the respondent which had refused to indemnify it. The plaintiff had purchased one of the units and it was found that the carpet on the set of stairs had been negligently laid. In June 1993, the carpet moved, causing the plaintiff to fall and break her ankle.

The contract of insurance entitled the appellant to indemnity for sums payable *"in respect of or arising out of or by reason of … personal injury … happening as the result of an occurrence …".* The period of that cover was expressed to operate *"in full force and effect"* until completion of the maintenance/defects liability period, which concluded at the end of March 1993. The carpet was negligently laid prior to that, but the plaintiff's fall occurred subsequently. The question for the court was – what was the "occurrence" which led to the plaintiff's injury? de Jersey CJ delivered the unanimous judgment of the Court of Appeal. The Chief Justice stated:

> *"… The contract defines the word "occurrence" to mean "the event (including a continuous or repeated exposure to substantially the same general conditions) from which a loss or series of losses may emanate.*
>
> The learned judge referred to the ordinary conception of "event", as being *"something that happened at a particular time, at a particular place, in a particular way … an occurrence or an incident"*, and took the view that the "event" here was *"the shifting of the carpet as [the plaintiff] walked upon it rather than the negligent laying of the carpet or the negligent inspection of the carpet as laid."* The appellant contends that *"the relevant "occurrence", the "event", was the negligent laying of the carpet and the related inspection…"*

The Chief Justice went on to conclude:

> *"The use of the word "event" would ordinarily invite one to focus on the proximate or immediate incident leading to the injury, here the shifting of the carpet, which occurred outside the period of insurance … What, in ordinary parlance,*

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was the "event", the happening or incident, for which [the plaintiff's] injury flowed? Surely the shifting of the carpet and her fall …"

Accordingly, this suggests that in determining whether something is an "Occurrence" within a construction liability policy, it will often be the "incident" which gives rise to the damage, rather than the work undertaken during the construction period which will be determinative of policy response. This highlights the need for Contractors to maintain a '*floater'* policy or procure '*Completed Operations'* cover.

Against the proposition advanced above is a New Zealand authority – *Bridgeman v Allied Mutual Insurance* (2000) 1 NZLR 433 in which it was found that farming operations represented by certain contracting work was the real cause of damage to a road in consequence of a land slip. In that case Nicholson J said that the doctrine of proximate cause was based on the presumed intention of the parties as expressed in the contracts which they had made. It must be applied with good sense so as to give effect to, and not defeat, that intention.

Staff Profile

Sally Morshead, Solicitor

Carter Newell is delighted to announce Sally's appointment to Carter Newell's Construction and Engineering team as a Solicitor. Sally has experience in commercial litigation specifically in the areas of Commercial Building Mediation, Body Corporate matters, Real Estate Litigation and Property Marketeering. Sally is a welcomed addition to the Construction and Engineering team.

International Recognition for CN Construction and Engineering

Team leader and Partner, Patrick Mead recently returned from Chicago, having co-chaired the Construction Specialty Group of the TAGLaw 2007 Northern Conference. Patrick addressed the group on developments in construction in Australia, specifically focusing on the move increasingly to Alliance Contracting as a method of project delivery, insurance issues arising in relation to Alliance Projects and the impact of security of payment legislation.

TAGLaw is one of the world's largest legal networks comprising more than 6000 lawyers at 150 independent firms in more than 90 countries around the world. Carter Newell is one of only two Australian TAGLaw firms. The network provides its members with access to expertise and knowledge in the global economy that extends to virtually every industry and every sector. Carter Newell's expertise in the field of Construction and Engineering has been recognised by Patrick's appointment as co-chair of this international Construction Specialty Group.

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