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Insurance Update

Commercial Lines

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“Design risk” or “construction risk”?

Virtually all construction contracts will have some kind of design element in them. Professional indemnity policies however will usually cover “design risks” but not “construction risks (which are normally covered by specific construction risks insurance). Just where the dividing line between those risks lies however can sometimes be difficult to discern, as this recent decision of the NSW Court of Appeal illustrates.

Baulderstone Hornibrook Engineering Pty Ltd (BHE) was the head contractor on the project to construct Sydney Airport’s third runway in the early 1990s. The contract was initially with the Federal Airports Corporation, and the FAC had a program of insurance for all consultants undertaking responsibilities in the design and construction of the third runway. As is usual in such situations, the insurance was in layers. HIH insured the first \$20 million; Gordian Runoff Ltd provided the next \$10 million; QBE the next \$6 million, CGU Insurance the following \$5 million layer and a syndicate at Lloyds provided a further layer of \$9 million.



The policies covered professional indemnity risks; but construction risks were specifically excluded. BHE had its own policy of professional indemnity insurance underwritten by AMP General Insurance.

Work commenced in early 1993 with practical completion achieved in August 1994. As the head contractor, BHE engaged various subcontractors. Two of those were Reinforced Earth Pty Ltd (RE), which was contracted to design the reinforced earth walls on the project; and Connell Wagner NSW Pty Ltd (CW) in relation to the provision of engineering services, including the reinforced earth walls.

By late 1996, subsidence was noted in the reinforced earth walls and BHE notified its insurers.

In June 2002, Sydney Airport Corporation Ltd (which had taken over operation of the airport from the FAC) sued BHE for damages in the Supreme Court. In June 2004, those proceedings were settled, with BHE undertaking to rectify the defects. The likely estimated sum for that work exceeded the levels at which both the Gordian and CGU policies would fully

respond.

BHE had in the meantime sought indemnity from the insurers participating in the professional indemnity program. In December 2003, it commenced proceedings against those insurers.

In the Supreme Court, Justice Einstein concluded that neither the Gordian nor the CGU policies responded. This was primarily because the liability of BHE for Sydney Airport’s claim against it was a claim arising out of (uninsured) construction risks and not arising out of (insured) professional indemnity risks; in particular that the damage was caused by negligence in the method of construction, not in the design of the project. He found that the proximate cause of the damage was inadequate compaction of backfill in the earth walls, and BHE’s failure to properly test it. BHE appealed.

In the Court of Appeal, the members of the court unanimously upheld Justice Einstein’s findings about the cause of the damage; notably that the proximate cause of the subsidence was BHE’s negligent construction of the earth walls and therefore the exclusion applied.

BHE also contended on appeal that the designs prepared by the subcontractors were flawed and as a result, even without the negligent backfilling, the earth walls were doomed to fail in any event. This, it said, meant that the error could be categorised as “design error” and therefore within the policy. The Court of Appeal found that, even on the most generous view of that argument for BHE, it did not alter the outcome because of the well-known *Wayne Tank* principle. That principle holds that if there are two causes of a loss, one excluded and the other not excluded, the policy does not respond.

Accordingly, even if there was negligence in the design aspects of the project, the findings of fact about the actual cause of the damage, combined with the *Wayne Tank* principle, meant that the policy still would not respond.

Baulderstone Hornibrook Engineering Pty Ltd v Gordian Runoff Ltd [2008] NSWCA 243

“Reasonable precautions” – a new construction

Construction insurance is a specialised and sometimes technical area of coverage, and its interaction with the equally specialised concepts of construction law has been tested in a recent case from the Supreme Court of NSW, in which the issue was whether the “all reasonable precautions” clause in a construction risks policy led to a construction contract being “incorporated” into the policy.

The case arose out of the Lane Cove tunnel collapse in 2005. Thiess Pty Ltd and John Holland Pty Ltd had formed the Thiess John Holland Joint Venture for the purpose of constructing the tunnel project. The joint venture held a



Insurance Update – Commercial Lines December 2008

construction risks insurance policy issued by Zurich Specialties London Limited and SR International SE in relation to the project.

After the collapse, the joint venture partners made a claim on the policy in February 2007. Negotiations over the claim then commenced, but in September 2008, the joint venture partners took the unusual step of serving a payment claim under the Building and Construction Industry Security of Payment Act (BCISPA) on the insurers. The insurers sought an urgent injunction to restrain the joint venture partners from proceeding under that Act.

In the NSW Supreme Court, Justice Bergin defined the key issue as being whether the BCISPA provisions applied in the circumstances. That led to a consideration of whether there was a construction contract that was “included or incorporated” so that it formed part of the insurance contract.

In that regard, the joint venture partners pointed to clause 18 of the policy, which required them to take “all reasonable precautions” to safeguard the “subject matter insured” (i.e. the project). They argued that this clause required them to take steps that, in certain circumstances, would “obviously” include construction work as that term is defined within the Act.

Justice Bergin noted that the policy had to be given a businesslike interpretation; and that from the decided cases, the purpose of the “all reasonable precautions” condition was to “ensure that the insured will not refrain from taking precautions which he knows ought to be taken because he is covered against loss by the policy”.

Since the commercial purpose of this Policy was to provide indemnity, clause 18 represented the imposition of a condition which had to be satisfied prior to indemnity being available. It was not an agreement by the joint venture partners to carry out construction work for the insurer, but an agreement by the insured that in carrying out the construction work for the project’s owners, they had to do so in a particular manner: that is, by taking reasonable precautions.

As such, the “all reasonable precautions” clause did not constitute a construction contract between the insurers and the joint venture partners. The BCISPA therefore did not apply to the policy.

Zurich Specialties London Ltd v Thiess Pty Ltd [2008] NSWSC 10s

Maintenance does not equal “advice”

The provision of “advice” is of course not the sole province of professionals, and the day-to-day work of many businesses will involve providing advice of some kind to customers or others. In an insurance context however, the fact that advice has been provided can lead to difficulties in claiming on public

or products liability policies, which typically exclude the provision of advice from coverage.



Norman Hall was employed by the Royal Australian Navy as a Navy Reservist. He worked four days a week as a facilitator and maintainer at a physical fitness facility at HMAS Stirling in Western Australia. The facility had a low ropes and high ropes course for the purpose of physical training activities. The course was located in bush, about 100 metres from the ocean. It had been built in 1993 by Rope Tech Australia Pty Ltd. Rope Tech Australia Pty Ltd was subsequently taken over by Adventure Training Systems Pty Limited (“ATS”).

Part of Mr Hall’s duties involved periodical inspection and maintenance of the high ropes course. On 29 January 2002, after carrying out an inspection of that course, he was preparing to abseil down from it. He attached the anchoring device for his abseiling rope to a loop of flexible steel rope. That loop was at one end of a length of wire rope called a safety stop. The other end of the safety stop was fixed to one of the rigid poles of the ropes course. This was found to be the correct abseiling procedure.

When he placed his weight on his abseiling rope, the safety stop from which it was suspended broke. He fell about 10 metres to the ground, suffering significant injuries. The trial judge has assessed his damages at slightly over \$1.4 million (which was not appealed).

Mr Hall sued both ATS and Transfield, the company contracted by the Commonwealth to maintain the plant and equipment at HMAS Stirling. Before the hearing, ATS went into liquidation and QBE (its public and product liability insurer) was joined into the action.

The case concerned a number of principles related to Transfield’s liability, which will be explored separately in our next General Insurance newsletter, but will not be canvassed here.

At trial, the trial judge found that QBE was not liable to indemnify ATS because of an exclusion clause in the policy relating to “advice, design, formula or specification given for a fee”; with the result that Mr Hall’s claim against QBE failed. Mr Hall appealed against that finding.



Insurance Update – Commercial Lines December 2008

The “general operative clause” in the policy read:

“The Underwriter will pay to or on behalf of the Insured all sums which the Insured shall become legally liable to pay by way of compensation including claimants’ costs and expenses (but excluding fines, penalties, punitive, exemplary and/or aggravated damages). This indemnity only applies to such liability arising out of the Insured’s Business (“the Business”) and as defined by each insured Section of this Policy, subject to the terms, conditions and exclusions of such Section and of this Policy as a whole.”

Separate sections of the policy covered public liability and product liability; but the initial claim on the policy by ATS was directed only to the product liability cover.

The exclusion clauses relied on by QBE related to “the rendering of or failure to render professional advice or service by the Insured or any error or omission connected therewith” and “advice, design, formula or specification given for a fee”.

In the Court of Appeal, three issues were identified; being:

- Whether the claim “arose out of” ATS’s business;
- Was the rope that failed a “product” within the meaning of the policy; and
- Did the exclusions relied on by QBE apply.

On the first issue, the members of the court agreed with the analysis of Justice Campbell that the claim did “arise out of” ATS’s business. The proposal form submitted by ATS made it clear that ATS had taken over the business of Rope Tech Australia and that it offered maintenance and inspection of the rope courses.

The court also unanimously found that the rope was a “product” for the purposes of the product liability section of the policy; and that the “professional advice” exclusion did not apply.

There was however a divergence of opinion on the issue of the exclusion clause relating to “advice... given for a fee”. Chief Justice McClellan noted that, prior to the accident, ATS had won a tender to “assess and certify” the course and to replace certain elements within the high ropes course. It was successful in the tender bid and carried out that work for a fee. QBE argued that ATS’s certification that the course was “safe” was “advice” that was provided for a fee.

Chief Justice McClellan observed that ATS’s business included the maintenance of facilities which it had supplied. He noted that the policy excluded liability for professional advice or advice given for a fee; as well as “design, formula, or specification given for a fee”. The common thread through those exclusions was the provision of information in the nature of intellectual property.

This was however not the task involved in carrying out a maintenance inspection of existing equipment and providing

an assurance that it was safe to use. The exclusion clause would only operate to exclude liability for “advice given for a fee” where that advice was given pursuant to a separate professional engagement in the nature of a consultancy distinct from its maintenance function.

As a result, the exclusion did not apply. Justice Beazley agreed with Chief Justice McClellan on that point (with Justice Campbell dissenting), with the result that Mr Hall’s appeal was allowed.

Transfield Services (Australia) v Hall; Hall v QBE Insurance (Australia) [2008] NSWCA 294

“Damage” is essential in ISR policy

Last year, we looked at the decision of the Supreme Court of Victoria in the matter of *Allstate Exploration v QBE Insurance*. That case has now had its sequel in the Court of Appeal.

To recap the facts, the claim arose out of the rock fall at the Beaconsfield Mine in Tasmania. This received national media coverage when two miners were trapped and later rescued. The rock fall was caused by unusual seismic activity. Shortly after the incident, an inspector ordered the mine closed under Tasmania’s Workplace Health & Safety Act. That led to the mine’s owners (a number of joint venturers) sustaining losses. They claimed those losses under an industrial special risks policy with QBE Insurance.

The decision turned on the interpretation of clause 23 in the QBE policy, which read:

Notwithstanding anything contained herein to the contrary, the Property Insured under this Policy is also covered against the risk of loss, destruction or damages arising from the actions of any civil authority during a conflagration or other catastrophe and for the purposes of preventing, minimising or retarding same and shall also include the closure of any Premises/operations by any civil authority due to the operation of a peril insured against.

The trial judge concluded that clause 23 of the policy was not engaged unless there was “physical loss, destruction of or damage to Property Insured”; and that since there had not been such physical loss, destruction or damage within the meaning of the policy, the claim failed. The joint venturers appealed to the Court of Appeal.

In the appeal, the joint venturers contended that the mine closure engaged the operation of clause 23 of the policy, and that such a closure was an insured event which was ‘due to the operation of a peril insured against’ within the meaning of the policy, even in the absence of any physical loss of the type described in the policy’s main insuring clauses. QBE however contended clause 23 has not been engaged by the mine closure because the closure was not due to any loss,



Insurance Update – Commercial Lines December 2008

destruction of or damage to 'property insured' within the meaning of the policy. This, it said was necessary to engage the business interruption cover provided by the policy.

Delivering the judgment for a unanimous Court of Appeal, Acting Justice Pagone noted that both Allstate's and QBE's arguments on the meaning of the clause had some difficulty.

Acting Justice Pagone found that the clause "undoubtedly" extended the cover provided by the Policy. The clause's primary focus however was to "identify additional causes of coverage" rather than to enlarge the indemnity beyond what was provided for elsewhere in the policy.

The policy was however always dependent on physical loss, destruction or damage occurring. Section 1 provided cover against the physical damage itself; while section 2 extended cover beyond physical damage but only in the event of the Property Insured being 'physically lost, destroyed or damaged'. The policy therefore did extend cover; but in all cases did so in the context of a "careful structure" and the specific extensions in the policy were all within that framework.

It therefore followed that trial judge's analysis was correct and that "physical loss, destruction of or damage to Property Insured" was required before clause 23 could be engaged. Since the joint venturers could not establish such physical damage, the appeal was dismissed.

Allstate Exploration NL v QBE Insurance (Australia) Ltd
[2008] VSCA 148

For further information, please contact a member of our National Insurance Team.

SYDNEY

Dean Newell | Partner

Tel 61 2 8233 9717 | Fax 61 2 8233 9555

Email dean.newell@daslaw.com.au

MELBOURNE

Tony Forgione | Partner

Tel 61 3 8080 3530 | Fax 61 3 8080 3599

Email tony.forgione@daslaw.com.au

BRISBANE

Kelli Stallard | Partner

Tel 61 7 3100 5112 | Fax 61 7 3100 5001

Email kelli.stallard@daslaw.com.au

CANBERRA

Keith Fleming | Partner

Tel 61 2 6201 7270 | Fax 61 2 6257 4011

Email keith.fleming@daslaw.com.au

PERTH

Brett Ablong | Partner

Tel 61 8 9265 6001 | Fax 61 8 9218 8264

Email brett.ablong@daslaw.com.au

www.daslaw.com.au

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