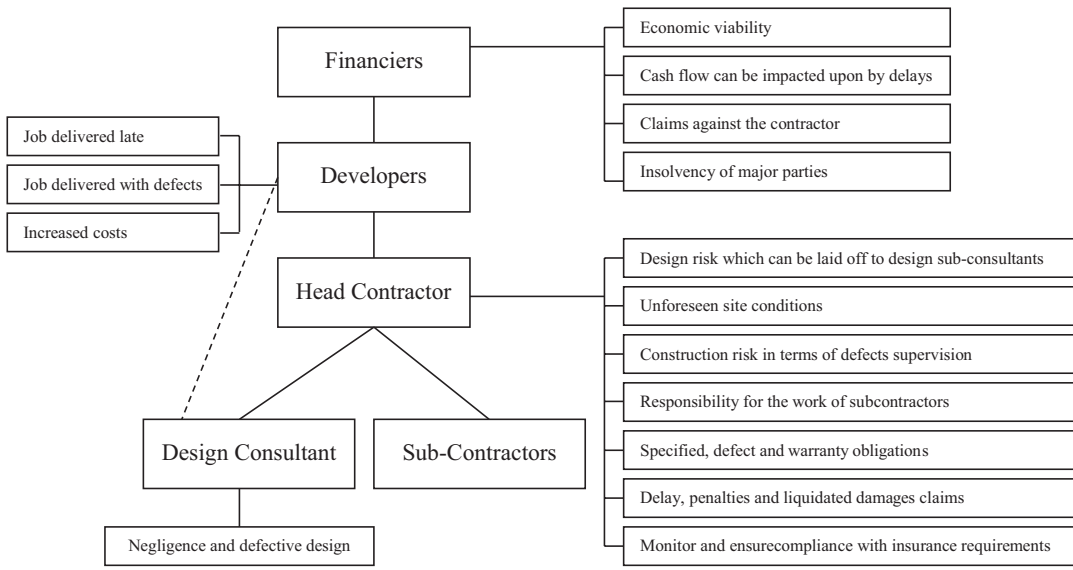
Insuring Risk in Construction Projects

Laina Chan*

Construction projects are inherently risky in terms of cost, time and quality. Part of the risk is managed by insurance. This article identifies the types of insurance that are typically available on construction projects and focuses upon Contractors All Risks Insurance and Professional Indemnity Insurance only. Both are forms of liability policies. Some of the key issues that can arise in considering the scope of coverage and indemnity under each type of policy are highlighted and discussed.



THE NEED FOR INSURANCE

Construction projects are inherently risky in terms of cost, time and quality. The parties therefore typically seek to contractually allocate these risks between them. The result of this allocation of risk and the application of the Abrahamson principles[1] is that the risks are pushed downwards to the design consultants and subcontractors. This allocation of risk is also accompanied by an obligation on some of the parties to obtain insurance to manage the risks that they have assumed.

In determining the insurance needs for each construction project, it is necessary to identify the risk that each of the parties to the project face. While the risks facing a principal can be summarised as time,

* Barrister, Selborne Chambers, Melbourne TEC Chambers and Director and Secretary of the Society of Construction Law Australia.

[1] Max Abrahamson, "Risk Management" (1984) 1 *International Construction Law Review* 241. The Abrahamson Principles provide that a party should bear the risk where: "a. the risk is within the party's control; b. the party can transfer the risk, eg through insurance and it is most economically beneficial to deal with the risk in this fashion; c. the preponderant economic benefit of controlling the risk lies with the party in question; d. to place the risk upon the part in question is in the interests of efficiency, including planning, incentive and innovation efficiency; and e. if the risk eventuates, the loss falls on that party in the first instance and it is not practicable or there is no reason under the above principles, to cause expense and uncertainty by attempting to transfer the loss to another."

cost and quality, the risks facing contractors are more extensive. They include design risks which can be laid off to the design sub-consultants; unforeseen site conditions; construction risk in terms of defects supervision; responsibility for the works of the subcontractors which can be dealt with via the provision of indemnities obtained from the subcontractors; specified, defect and warranty obligations; delay, penalties and liquidated damages claims as well as the obligation to monitor and ensure compliance with the insurance requirements of subcontractors. The risks facing design consultants are the risk of negligent and defective design. The risks facing financiers include the economic viability of the project, ensuring cash flow from the project which can be impacted upon by delays, claims against the contractor and the insolvency of major parties.

Once the risk is identified, the following issues then have to be considered in deciding whether the risk is insurable and if so, whether it should be so insured:

(a) Is the risk insurable?
(b) If the risk is insurable, is the cover adequate?
(c) Is the cost of the insurance prohibitive such that the costs outweigh the risk to be insured?
(d) What is the nature of the policy? In other words, how long does the policy operate to provide cover and what are the preconditions and conditions to indemnity?
(e) Can the policy be tailored or negotiated to the specific needs of the insured?
(f) The solvency and long-term viability of the insurer.

Types of Insurance

These include:

(a) Contractors All Risks Insurance policies which provide cover for property damage as well as liability for third-party property damage and personal injury during the construction phase of a project;
(b) Industrial Special Risk policies which take over insurance of the project once the works are complete;
(c) Professional Indemnity policies which cover civil liability for loss and damage arising from the design professional's failure to exercise reasonable care and skill in the discharge of their retainer;
(d) Public Liability Insurance which provides cover for third-party property damage and personal injury;
(e) Workers Compensation;
(f) Compulsory Third-Party Motor Vehicle; and
(g) Marine Cargo or Transit.

This article will focus upon Contractors All Risks Insurance and Professional Indemnity Insurance only. Both are forms of liability policies. Some of the key issues that can arise in considering the scope of coverage and indemnity under each type of policy are highlighted and discussed.

Contractors All Risks Insurance

The Insured under the Policy

The Contractor usually takes out the contract works policies. However, it can also be taken out on a principal-controlled or project manager-controlled basis and in such case the principal, project manager, contractors and subcontractors should be named as insured under the policy. This reflects the intention that the policy is for the benefit of the principal, its contractors and subcontractors. The High Court in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*[2] held that a non-signatory party to an insurance contract who has not provided any consideration can enforce the policy of insurance for its own benefit where the objective intention of the policy of insurance is that the parties to the policy intended it to be insured.

[2] *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107; (1990) 6 BCL 97.

The position in Australia has now been codified by the 1995 amendment to the *Insurance Contracts Act 1984* (Cth) which saw the addition of s 48.[3] Sections 16[4] and 17[5] of the *Insurance Contracts Act 1984* are also relevant. By the operation of s 16, it is not necessary for the insured to have had an insurable interest at the time that the contract of insurance was entered into. By reason of s 17, an insured need not have a proprietary interest (either legal or equitable) in the subject matter of the risk at the time of the loss either. All that is required to engage the operation of the policy is for the insured to have suffered a monetary loss.

The Extent of the Cover

Contract works insurance is an occurrence-based combined material damage and liability policy. The first part of the policy insures against physical loss or damage to the works under construction, materials for the project stored onsite and offsite, and temporary works. Hire plant and equipment as well as contractor's plant and equipment, temporary buildings and employees effects are often excluded from cover. The second part of the policy insures against liability for third-party property damage or personal injury arising from construction activities on and off the site.

In determining whether cover is engaged under a policy of insurance, it must be borne in mind that a policy of insurance is a commercial contract and is construed so as to give it a business-like interpretation. It is therefore necessary to consider the language used by the parties in its ordinary meaning, the circumstances addressed by the contract as well as the social purpose and objects that it is intended to secure. The policy is to be construed in the context of the surrounding circumstances. The market or commercial context in which the parties are operating is relevant and a court will assess how a reasonable person in the position of the parties would have understood the language.[6] The commercial purpose of the agreement calls for an understanding of the genesis of the transaction, the background, the context and the market within which the parties are operating.[7]

Fortuity Principle

Policies of insurance are premised upon the fortuity principle. Indemnity is provided for civil liability where the damage is unexpected and accidental only.[8]

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[3] *Insurance Contracts Act 1984* (Cth) s 48(1) provides: "A third party beneficiary under a contract of general insurance has a right to recover from the insurer, in accordance with the contract, the amount of any loss suffered by the third party beneficiary even though the third party beneficiary is not a party to the contract."

[4] *Insurance Contracts Act 1984* (Cth) s 16(1) provides: "A contract of general insurance is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in a subject-matter of the contract."

[5] *Insurance Contracts Act 1984* (Cth) s 17 provides: "Where the insured under a contract of general insurance has suffered a pecuniary or economic loss by reason that property the subject-matter of the contract has been damaged or destroyed, the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the insured did not have an interest at law or in equity in the property."

[6] *Todd v Alterra at Lloyds Ltd* (2016) 239 FCR 12, 22–23 (Allsop CJ and Gleeson J); [2016] FCAFC 15 summarising the principles in *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 76 NSWLR 603, [19]–[23]; [2009] NSWCA 407; *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579, [22] (Gleeson CJ), [73]–[74] (Kirby J); [2000] HCA 65; *Wilkie v Gordian Runoff Ltd* (2005) 221 CLR 522, [15], [16] (Gleeson CJ, McHugh, Gummow and Kirby JJ); [2005] HCA 17; *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513, 520–521 (Gibbs CJ); see also Kirby J (in dissent) in *Johnson v American Home Assurance Co* (1998) 192 CLR 266, [19]; [1998] HCA 14; *International Air Transport Association v Ansett Australia Holdings Ltd (Subject to Deed of Company Arrangement)* (2008) 234 CLR 151, [8]; [2008] HCA 3; *Durham v BAI (Run Off) (in Scheme of Arrangement)* [2009] 2 All ER 26, [202]–[204]; [2008] EWHC 2692. See also *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104, 116–117 (French CJ, Nettle and Gordon JJ); [2015] HCA 37 affirming the law set out in *Codelfa Construction Pty Ltd v State Rail Authority* (NSW) (1982) 149 CLR 337; 1 BCL 16, *Electricity Generation Corp v Woodside Energy Ltd* (2014) 251 CLR 640; [2014] HCA 7; *Horsell International Pty Ltd v Divetwo Pty Ltd* (2013) 18 ANZ Insurance Cases 61-991, [151]–[157]; [2013] NSWCA 368.

[7] *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 1 WLR 989, 995–996 (Wilberforce L).

[8] The concept of "accidental" was discussed in *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513, 532; *Hurley Contractors Ltd v Farmers Mutual Association* (1991) 6 ANZ Insurance Cases 61-076; *Mount Albert City Council v New Zealand Municipalities Co-op Insurance Co Ltd* [1983] NZLR 190, 194 (Cooke J).

A useful illustration of what constitutes accidental damage is in *Matton Developments Pty Ltd v CGU Insurance Ltd*.[9] The Queensland Court of Appeal had to consider whether the damage to a crane had been accidental or whether the insured had deliberately courted the risk. The policy provided extended cover for accidental overloads. The damage to the crane had occurred in the course of lifting a concrete tilt panel when the boom of the crane collapsed and the crane was damaged beyond economical repair. The issue was whether the overloading of the crane was neither unexpected nor unforeseen and thus not accidental. McMurdo P was satisfied on the facts that both the overloading and the damage were uninvited, unlooked for mishaps and untoward events not expected or designed. While the insured deliberately took a risk, he was by no means inviting the disaster that followed.[10] Morrison JA was not satisfied that:[11]

(a) the "risk of the mishap was foreseen or courted even though it was thought unlikely that it would occur";[12] or
(b) they were gambling or courting the risk, or taking a calculated risk, deliberately accepting the outcome; or
(c) that they voluntarily embarked on a foolhardy venture, with the damage an inevitable consequence, by "courting, inviting or wooing" of the risk; or
(d) that they deliberately incurred the risk.

In *Sheehan v Lloyds Names Munich Re Syndicate Ltd*,[13] Allsop J said that the issue of whether damage falls within the cover for accidental loss or damage under a policy is a question of construction, informed by the principles that have developed around the question whether an event is an accident or loss is accidental loss for the purposes of insurance law. The meaning is ultimately to be determined based on the policy wording and context.[14]

Accidental damage must involve something "fortuitous and unexpected".[15] Allsop J endorsed the statement of Starke J in *Robinson v Evans Bros Pty Ltd*[16] where his Honour stated that, for the purposes of determining whether an event is an accident:

> The test I think is, whether an ordinary, reasonable sensible [person], in the position of [the insured] would or would not have expected the occurrence. … The test is I think objective and not subjective: whether an ordinary, reasonable man with the knowledge, information and experience of [the insured] reasonably would have expected the event that did happen …

Allsop J confirmed that the test (to the extent that it is appropriate to refer to it as a test) is an objective one. However, it incorporates the specific knowledge and experience of the person involved.[17]

The recent English case of *Leeds Beckett University v Travelers Insurance Co Ltd*[18] summarised the principles in relation to accidental damage. Accidental damage means damage that was caused by a chance event, against the risk of which insurance was taken out. Accidental damage does not mean damage that is inevitable. Accidental damage does not mean damage that was inevitable with inevitability being assessed prospectively from the time that cover was taken out. Accidental damage also does not

[9] *Matton Developments Pty Ltd v CGU Insurance Ltd* [2017] 1 Qd R 467; [2016] QCA 208.

[10] *Matton Developments Pty Ltd v CGU Insurance Ltd* [2017] 1 Qd R 467, [10]; [2016] QCA 208.

[11] *Matton Developments Pty Ltd v CGU Insurance Ltd* [2017] 1 Qd R 467, [101]; [2016] QCA 208 (footnotes omitted).

[12] An "accident" has been variously described as an "unlooked-for mishap or an untoward event which is not expected or described" or "any unintended and unexpected occurrence which produces hurt or loss": *Fenton v J Thorley & Co Ltd* [1903] AC 443, 448 (Lord Macnaghten), 452 (Lord Lindley). See also *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513, 533–534 (Wilson, Deane and Dawson JJ) where this expression was adopted.

[13] *Sheehan v Lloyds Names Munich Re Syndicate Ltd* [2017] 19 ANZ Insurance Cases 62-158; [2017] FCA 1340.

[14] *Australian Casualty Co Ltd v Federico* (1986)160 CLR 513, 525 (Wilson, Deane and Dawson JJ).

[15] *De Souza v Home & Overseas Insurance Co Ltd* [1995] LRLR 453, 458; *Sheehan v Lloyds Names Munich Re Syndicate Ltd* [2017] 19 ANZ Insurance Cases 62-158, [63]; [2017] FCA 1340.

[16] *Robinson v Evans Bros Pty Ltd* [1969] VR 885, 896.

[17] *Sheehan v Lloyds Names Munich Re Syndicate Ltd* [2017] 19 ANZ Insurance Cases 62-158, [65]; [2017] FCA 1340.

[18] *Leeds Beckett University v Travelers Insurance Co Ltd* [2017] Lloyd's Rep IR 417, 449 [208].

mean damage to the property due to the inherent characteristics of that property. A policy of insurance covers damage that is caused by an external fortuitous event but not damage that is caused by an inherent weakness in that property.

There can be an external fortuitous event which causes damage to the rigs while they are being shipped because of their natural behaviour in the ordinary course of the voyage. Lord Saville said that the external fortuitous event took the form of the rolling and pitching of the barge in the sea conditions encountered catching the first leg of the rig at just the right moment to produce stresses sufficient to cause the leg to break off, thereby leading to increased stresses on the remaining legs and their subsequent breakage.[19]

Contractor's all risks policies typically include a "due care" clause where the insured agrees to take all reasonable precautions to prevent loss, damage or liability. The "due care" clause moderates the full effect of the fortuity principle. Diplock LJ in *Fraser v BN Furman (Productions) Ltd*[20] commented on the proper construction of a "due care" clause. "Reasonable" does not mean reasonable as between the employer and the employee. It means reasonable as between the insured and the insurer having regard to the commercial purpose of the contract, which is in part, to indemnify the insured against liability for his – the insured's – personal negligence. The insured must take measures to avert dangers that the hypothetical reasonably careful employer would have foreseen. The insured should not deliberately court a danger, the existence of which he recognises, by refraining from taking any measures to avert it or by taking measures which he himself knows are inadequate to avert it. The employer's omission to take any particular precautions to avoid accidents must be at least reckless, made with actual recognition by the insured himself that a danger exists, and not caring whether or not it is averted.

In *CGU Insurance Ltd v Lawless*,[21] Redlich JA noted that the test is wholly subjective. A failure to take reasonable precautions will occur only where there is a deliberate course of action or inaction which the insured realises exposes him to the risk of someone being injured by the danger which has been recognised. The insured might establish compliance with the condition by showing one or more of the following things:

(a) there was no recognition of the danger or the extent of the danger of bodily injury;
(b) particular precautions would not have been reasonable in the circumstances;
(c) no particular precaution was considered or it was not regarded as reasonable or practicable in the circumstances; and
(d) the failure to take the precautions was not due to a lack of desire and concern to prevent bodily injury.

Causation

The causation inquiry in insurance law is directed to determining the proximate cause of the relevant loss or damage in terms of proximate in efficiency and not the last in time.[22] A proximate cause is determined based upon a judgment as to the "real", "effective", "dominant" or "most efficient" cause.[23] Determining what is proximate in a case is a matter of judgment, applying the commonsense knowledge of a business person. The court should first seek to identify a single proximate cause of the loss or damage.[24] If a

[19] *Global Process Systems Inc v Syarikat Takaful Malaysia Berhad* [2011] 1 All ER 869, [46]; [2011] UKSC 5.

[20] *Fraser v BN Furman (Productions) Ltd* [1967] 1 WLR 898, 905–906. This test has been approved and expanded in *Albion Insurance Co Ltd v Body Corporate Strata Plan No 4303* [1983] 2 VR 339, 344–345. See also the recent application of the test in *Barrie Toepfer Earthmoving and Land Management Pty Ltd v CGU Insurance Ltd* (2016) 75 MVR 108; [2016] NSWCA 67.

[21] *CGU Insurance Ltd v Lawless* [2008] VSCA 38, [17].

[22] *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350, 369 (Lord Shaw); *Global Process Systems Inc v Syarikat Takaful Malaysia Berhad (The "Cendor MOPU")* [2011] 1 Lloyds Rep 560, 564 [19] (Lord Saville), 568 [49] (Lord Mance); [2011] UKSC 5.

[23] see *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350, 370 (Lord Shaw); *Wayne Tank & Pump Co Ltd v Employers Liability Assurance Corp Ltd* [1974] QB 57, 66 (Lord Denning MR); *Sheehan v Lloyds Names Munich Re Syndicate Ltd* [2017] 19 ANZ Insurance Cases 62-158, [77]; [2017] FCA 1340.

[24] *Sheehan v Lloyds Names Munich Re Syndicate Ltd* [2017] 19 ANZ Insurance Cases 62-158, [77]; [2017] FCA 1340.

conclusion is reached that there are instead multiple proximate causes, and one is an insured event but the other is not, then the insured will be able to recover. However, where there are two proximate causes and these are concurrent and interdependent, and where one is an insured event and one is an excluded event then as a matter of construction of the policy the insured will not be able to recover. The causes are inseparable, and as one is excluded under the policy, recovery will not be possible.[25]

No Cover for Pure Economic Loss

The insuring clause for contract works covers loss or damage to specified contract works within a defined territory occurring during the period of insurance. The principle of fortuity in insurance contracts means that insurers will cover loss or damage that happens by chance so long as the terms and conditions of the policy of insurance are otherwise satisfied. The insured does not have to establish the reason for the loss or damage. However, it is only physical loss or damage that is covered. There is generally no cover for pure economic loss.

This is significant because building defects are not considered to be physical loss or damage. Where a construction or building defect is discovered before any injury to person or health, or damage to property – other than the defective house itself – has been done, the expense incurred by a subsequent purchaser of the house in putting the defect right is pure economic loss: *Murphy v Brentwood DC*,[26] *Delta Pty Ltd v Team Rock Anchors Pty Ltd*[27] and *Woolcock Street Investments v CDG Pty Ltd*.[28] The nature of the damage that an Owners Corporation might suffer (as agent for the owners of the lots) by reason of the defects in the common property is also pure economic loss.[29]

The policy wording would therefore have to clearly extend cover to third-party claims in contract for pure economic loss in order for a policy to cover pure economic loss. However, the issue of what constitutes property damage can be complex.

Property Damage

Property damage generally requires some form of physical alteration or change, not necessarily permanent or irreparable, which impairs the value or usefulness of the thing said to have been damaged.[30] In *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (*Graham Evans*),[31] the plaintiff agreed to erect a building and retain a surveyor to lay out grids on the site, to be used for the location and identification of particular features on each level of the building. When the construction of the building reached the fifth level, it became clear that the surveyors had laid the grids wrongly. The evidence showed that the probable cause of the errors was defective measurement using a tape measure and defective use of the plumb-bob or similar apparatus. The plaintiffs sought indemnity under a policy of insurance which covered "all risks of physical loss of or damage to property of every kind and description (including the whole of the Contract Plant, Equipment, Materials and Supplies up to but not exceeding the respective sums insured in the Schedule) owned by the Insured or for which the

[25] *Sheehan v Lloyds Names Munich Re Syndicate Ltd* [2017] 19 ANZ Insurance Cases 62-158, [81]; [2017] FCA 1340. This is known as the *Wayne Tank* principle. See also *McCarthy v St Paul International Insurance Co Ltd* (2007) 157 FCR 402, 430–431 [91]–[93], 432 [97], 434 [104], 438 [114]; [2007] FCAFC 28 for an analysis of the *Wayne Tank principle.*

[26] *Murphy v Brentwood DC* [1991] 1 AC 398, 464–468, 479.

[27] *Delta Pty Ltd v Team Rock Anchors Pty Ltd* [2018] 1 Qd R 564; [2017] QSC 115.

[28] *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515, 529; [2004] HCA 16.

[29] *Brookfield Multiplex Ltd v Owners – Strata Plan No 61288* (2014) 254 CLR 185, 208, 227 (Hayne and Kiefel JJ), 213 (Crennan, Bell and Keane JJ), 241 [174] (Gageler J); [2014] HCA 36.

[30] *Switzerland Insurance Australia Ltd v Dundean Distributors Pty Ltd* [1998] 4 VR 692; *Bayer Australia Ltd v Kemcon Pty Ltd* (1990) 6 ANZ Insurance Cases 61-026; *Mainstream Aquaculture Pty Ltd v Calliden Insurance Ltd* (2011) 16 ANZ Insurance Cases 61-911; [2011] VSC 286; *AXA Global Risks (UK) Ltd v Haskins Contractors Pty Ltd* (2004) 13 ANZ Insurance Cases 61-611; [2004] NSWCA 138.

[31] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772.

Insured may be responsible or, prior to any occurrence for which may be made hereunder, assumed responsibility, used or to be used in part of or incidental to the 'Insured's Contracting Operations' detailed in the Schedule".[32]

The issue was therefore whether the defects in the building constituted physical damage to property. Dowsett J said that "'damage' involves in my view in the way in which the word is used in this context, some injury to property".[33] There had not been any physical loss of property or damage.

The building materials which were used in the construction of the building did not continue to be owned by the Insured in the common sense in which the word is used after that incorporation into the building.[34] Further, even if the property could be taken to be the building, it is difficult "to see how that building was to be used as part of or incidental to the insured's contracting operation". The loss was therefore not within the risk insured under the policy.[35]

In *AXA Global Risks (UK) Ltd v Haskins Contractors Pty Ltd*,[36] the issue was whether a contract works and liability insurance policy responded to the damage. Haskins Contractors had entered into a building contract to construct a subdivision project at Bayview. The construction of two timber crib retaining walls was subcontracted. The eastern wall was completed in October 1999 and the western wall completed in March 2000. During March 2000 various defects and non-conformities were identified with the construction of the walls. The defective works were not rectified. As time progressed, damage was observed in the walls, including the splitting and crushing of headers. At issue was whether relevant physical loss and damage had occurred within the policy period of 31 December 1999 to 31 December 2000. A distinction was drawn between property that is liable to be damaged and property that is damaged. Although the eastern wall was defective when built, until the defects manifested themselves in injury to the structure there was no "physical damage to the property insured" within the meaning of the policy. Unfortunately for the insured, the damage in the eastern wall did not manifest itself until after the policy period.

In *Delta Pty Ltd v Team Rock Anchors Pty Ltd*,[37] the Court had to consider whether the contractor had suffered property loss. Queensland Investment Corporation (QIC) owned land at 175 Albert Street, Brisbane. QIC had entered into a contract with the plaintiff, Delta, to undertake excavation works on the site. In September 2006 QIC contracted with Watpac as the builder, and the contract between QIC and Delta was novated so that Delta was in a contractual relationship with Watpac. Delta engaged the first defendant (TRA) to install anchors and walers to secure the retaining walls for the basement excavation. TRA began work in November 2006. The performance of TRA was woeful[38] and one section of the retaining wall moved excessively. The Court said that wall movement independent of damage to tangible property could not constitute property loss.[39] The costs of rectification[40] constituted economic loss and not property loss.[41]

[32] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772, 74,691.

[33] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772, 74,693.

[34] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772, 74,694.

[35] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772, 74,694.

[36] *AXA Global Risks (UK) Ltd v Haskins Contractors Pty Ltd* (2004) 13 ANZ Insurance Cases 61-611; [2004] NSWCA 138.

[37] *Delta Pty Ltd v Team Rock Anchors Pty Ltd* [2018] 1 Qd R 564; [2017] QSC 115.

[38] *Delta Pty Ltd v Team Rock Anchors Pty Ltd* [2018] 1 Qd R 564, [6]; [2017] QSC 115. The great majority of anchors installed were not in accordance with the shop drawings. The bundles of wire tendons did not contain sufficient tendons. Nor were they long enough. Nor were they grouted into position properly at their ends. They were not capable of performing as they should have done.

[39] *Delta Pty Ltd v Team Rock Anchors Pty Ltd* [2018] 1 Qd R 564, [93]; [2017] QSC 115.

[40] The basement was refilled and re-excavated; existing ground anchors were tested, and supplementary ground anchors were installed. There was delay and the cost of the work.

[41] *Delta Pty Ltd v Team Rock Anchors Pty Ltd* [2018] 1 Qd R 564, [91]; [2017] QSC 115.

No Cover for Defective Workmanship and Design

Contract works policies do not cover risk associated with defective workmanship and design. In Australia, with the exception of home warranty insurance prescribed by the various legislatures (except Tasmania) to cover breach of the statutory warranties in limited circumstances[42] and bespoke Inherent Defects Insurance policies that can be written to cover faulty design, engineering, workmanship and materials in load bearing elements for a period of 10 years, there is typically no insurance that covers risk for defective workmanship.

In *Lennar Corp v Great American Insurance*,[43] Lennar had applied a synthetic stucco called Exterior Insulation and Finish System (EIFS) to about 400 homes. EIFS was defectively designed in that it trapped water behind it and did not allow the water to drain. The trapped water then caused water damage to the homes. The evidence showed that Lennar's intent to fully remove and replace the EIFS was a preventative measure because it was defective. Lennar's costs to remove and replace EIFS as a preventative measure and its overhead costs, inspection costs, personnel costs, and attorneys' fees were held to be not "damages because of … property damage". Consequently, the Insurers had no duty to indemnify Lennar for these costs. However, Lennar's costs to repair water damage to the homes were "damages because of … property damage".

In *Graham Evans*[44] the issue arose as to whether coats of paint once applied to a 26-storey building can constitute property. In this case, three coats of paint had been applied to the building. The first coat was a cement-primer intended to be applied to, and to some degree bond with, the cement surface of the exterior walls. The second coat was an undercoat intended to bond with the primer coat and provide a textured surface for the third finishing coat which, in the case of the building in question was intended to provide a rippled external surface. The manufacturers of the paint also supplied a specification as to the manner in which the ingredients for the different coats should be mixed and applied. As it turned out, the specification for the primer was defective in that the specifications caused the primer coat to have been applied in an overly dilute form which had caused the primer to fail to achieve adequate adhesion to the concrete surfaces of the wall and adequate cohesion within itself. As a result, the other two coats were prevented from adhering to the walls of the building. The paintwork flaked off in many areas of the building and the plaintiff, as a responsible building company had to strip a considerable amount of paintwork with a view to large areas being repainted.

The policy provided cover in the same terms as the policy cited in the case referred to above of *Graham Evans*.[45] The defendants denied that the loss suffered by the plaintiff fell within the cover provided by the policy. If it did, the defendants argued that they could rely upon a provision of the policy excluding "loss or damage directly caused by defective workmanship, construction or design", although it was provided that the exclusion "shall be limited to the part which is defective and shall not apply to any other part or parts lost or damaged in consequence thereof".

Foster J noted that the policy was a commercial document and had to be construed beneficially in favour of the insured. The plaintiff had brought itself within the insuring clause on the basis that the rendering useless and valueless of the second and third coats of paint of considerable magnitude separately applied and composed of different ingredients, and their necessary stripping from the building, constitutes relevantly physical loss or damage to the coats of paint.[46]

The defective workmanship only related to the preparation and/or application of the primer coat. As the defective workmanship had caused damage to the primer coat only and not to the second and third coats

[42] Under *Home Building Act 1989* (NSW) Pt 6; *Building Act 2004* (ACT) Pt 6; *Building Act 1993* (NT) s 24(3), Pt 5A Div 3; *Building Work Contractors Act 1995* (SA) Pt 5 Div 3; where the builder has died, disappeared or become insolvent. Under *Queensland Building and Construction Commission Act 1991* (Qld) Pt 5; *Building Act 1993* (Vic) Pt 9 Div 3; where the building work is incomplete.

[43] *Lennar Corp v Great American Insurance* 2006 Tex Appeal LEXIS 1457.

[44] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1986) 4 ANZ Insurance Cases 60-689.

[45] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772.

[46] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1986) 4 ANZ Insurance Cases 60-689, 74,101.

of paint, the exclusion clause for defective workmanship only excluded cover for the loss or damage to the primer coat. Any causal effect of the defective workmanship to the second and third coats of paint was indirect. The exclusion clause therefore did not operate to preclude cover for the loss or damage to the second and third coats of paint.[47]

In *Chalmers Leask Underwriting Agencies v Mayne Nickless Ltd* (*Chalmers Leask*),[48] the High Court had to consider the following exclusion clause that "loss or damage directly caused by defective workmanship, material or design or wear and tear, or mechanical breakdown or normal upkeep or normal making good but so that this exclusion shall be limited to the part immediately affected and shall not apply to any other part or parts lost or damaged in consequence thereof". A claim was made under the policy in respect of damage caused to flood mitigation works through the breaching by flood waters of a coffer dam that had been impacted by vehicles passing over its top.

The High Court was satisfied that the claim for "de-silting" was not part of loss or damage caused by the alleged defective workmanship, material or design of the coffer claim. The exclusion of loss or damage caused by defective workmanship, material or design was limited to the part immediately effected and did not apply to any other part or parts lost or damaged in consequence thereof.[49]

The principle in *Chalmers Leask* was applied in *Walker Civil Engineering v Sun Alliance & London Insurance PLC*.[50] The insured, Walker had contracted to build three sewerage pumping stations. When construction of the sewerage stations was almost complete, the fibreglass sewerage tanks started to leak. During reconstruction of the tanks, concrete which had been poured on top of the fibreglass tanks to counter the hydrostatic ground pressure which had caused the tanks to pop, had to be jack-hammered and removed. The insured did not claim for the cost of the replacement of the fibreglass tanks, but claimed for the costs of removing the concrete as being loss or damage flowing from the necessity to carry out rectification works.[51]

Rolfe J at first instance was satisfied on the evidence before him that the concrete was an integral part of the tanks such that the totality of the tank structure was infected with defective workmanship, construction or design. He held that to draw any distinction between the different components of the tank was not justified and he was not satisfied that in the circumstances of the case the concrete constituted "any other part or parts" within the meaning of the exclusion clause.

Rolfe J distinguished the case of *Graham Evans* in the following way:

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[47] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1986) 4 ANZ Insurance Cases 60-689, 74,101–74,102. Note the discussion of Mason P of this case in *AXA Global Risks (UK) Ltd v Haskins Contractors Pty Ltd* (2004) 13 ANZ Insurance Cases 61-611, [43]; [2004] NSWCA 138 who held that it was not surprising that the second and third coats of paint were covered by the policy because they had been rendered useless and valueless by the inadequacy of the primer coat.

[48] *Chalmers Leask Underwriting Agencies v Mayne Nickless Ltd* (1983) 155 CLR 279.

[49] *Chalmers Leask Underwriting Agencies v Mayne Nickless Ltd* (1983) 155 CLR 279, 282 (Gibbs CJ). For the approach taken in Canada, see *Ledcor Construction Ltd v Northbridge Indemnity Insurance Co* [2016] 2 SCR 23, [119]; [2016] SCC 37 where Cromwell J held that "making good faulty workmanship" means "the cost of redoing the faulty work". Cromwell J held that the principle does not operate at a very high level of generality. Applying that principle turns on the scope of the faulty work and the nature of redoing it, and its application in other cases will ultimately be decided on a case-by-case basis in light of the particular circumstances of the particular case.

[50] *Walker Civil Engineering v Sun Alliance & London Insurance PLC* (1996) 9 ANZ Insurance Cases 61-311 (and affirmed on appeal in (1999) 10 ANZ Insurance Cases 61-418).

[51] The insuring clause provided: "This section, subject to the limitations, exclusions, terms and conditions hereinafter mentioned, is to ensure in respect of occurrences happening during the period stated in the Schedule against all risks of physical loss of or damage to property of every kind and description (including the whole of the contract plant, equipment, materials and supplies up to but not exceeding the respective sums Insured in the Schedule) owned by the insured or for which the Insured may be responsible or, prior to any occurrence for which claim may be made hereunder, have assumed responsibility, use or to be used in part of or incidental to the 'Insured's Contracting Operations' detailed in the Schedule wherever the said property may be located in Australia or whilst in transit within and between any place or places therein." Exclusion 2(c) provided: "This insurance does not cover loss or damage directly caused by defective workmanship, construction or design or wear and tear or mechanical breakdown or normal upkeep or normal making good but this exclusion shall be limited to the part which is defective and shall not apply to any other part or parts lost or damaged in consequence thereof."

> His Honour held, as I understand it, that whilst the three coats of paint were necessary to establish a finished painted surface, only the first coat was defective and that lack of quality in it caused damage to the second and third coats. I consider His Honour's reasoning to be that each of the second and third coats had a function to perform, which was independent of that to be performed by the first coat, notwithstanding that all coats were necessary to bring about the desired result. Accordingly the facts of that case are distinguishable from the present where the concrete had no other function to perform than to stabilise the fibreglass tanks.[52]

Insofar as Foster J had found that the causal connection was indirect rather than direct, Rolfe J disagreed. It is impossible to conclude that the damage to the second and third coats did not arise directly from the failure of the first coat or that there was indirect causation. The correct approach to that case should have been whether it could be said on a proper construction of that clause, that the second and third coats were " 'other part or parts'".[53]

Rolfe J was guided by the High Court in *Chalmers Leask* because he was satisfied that the damage caused to the construction works in *Chalmers Leask* as a result of the failure of the coffer dam was consequential loss or damage to the works which the insured had been constructing and was not loss or damage to the coffer dam itself. By contrast, in the present case, a similar distinction could not be drawn between the fibreglass tanks and the concrete which had been poured onto the fibreglass tanks to stabilise it against the hydrostatic ground pressure.

The NSW Court of Appeal dismissed the appeal.[54] The appellant's claim is properly characterised as a claim to be indemnified under the policy for the cost of reinstating the defective part, namely the fibreglass tanks as a whole. It was not a claim in respect of any other part or parts lost or damaged in consequence of defective workmanship, construction or design. Sheller JA then went on to record his disapproval of the conclusion in *Graham Evans*. Sheppard AJA who handed down the main judgment also distinguished the case of *Graham Evans*. The loss or damage suffered by the appellant as a result of having to remove the tanks because of their defectiveness was "directly caused" by the need to replace them.[55]

In *Cementation Piling and Foundations Ltd v Aegon Insurance Co Ltd and Commercial Union Insurance Co PLC*,[56] the case had proceeded before the primary judge by statement of agreed facts. Cementation were contractually bound to complete and maintain bored piling and continuous walls forming part of a series of quays to be constructed within the existing dock at Barrow-Inn-Furness. The area was reclaimed from the sea by depositing pumped sand to form a land area of berm some 7ha in area protruding 2.5m above sea level. The walls were designed and constructed to retain the sand wholly within the berm. The walls were constructed by excavating cavities in the sand in the shape of the concrete sections which would form the walls of the dock. Steel reinforcement cages were lowered into the cavity which were then filled with liquid concrete. At the joints between the section, side panels were cast in such a shape as to enable the next panel to abut and provide a tight fit behind the wall in the finished dock. The design did not provide for any form of tie between the panels. Upon completion of the sections, the sand in the centre of the structure was dredged out. As the sand was removed, the sea water was permitted to enter and take its place.

In September 1985 it was discovered that quantities of the sand fill which had previously been placed in the area retained by the walls had escaped into the newly constructed dock. On inspection of the

[52] *Walker Civil Engineering v Sun Alliance & London Insurance PLC* (1996) 9 ANZ Insurance Cases 61-311, 76,456.

[53] *Walker Civil Engineering v Sun Alliance & London Insurance PLC* (1996) 9 ANZ Insurance Cases 61-311, 76,456.

[54] *Walker Civil Engineering Pty Ltd v Sun Alliance & London Insurance PLC* (1999) 10 ANZ Insurance Cases 61-418.

[55] A similar approach was taken in *Prentice Builders Ltd v Carlingford Australia General Insurance Ltd* (1988) 6 ANZ Insurance Cases 60-951 where Fullager J held that "there is no difference in character between what Mr Shaw calls rectification of non-defective parts and what he calls rectification of defective parts because both parts merely are constituents of a defective whole, or a whole that embodies, as a whole, defective workmanship." As a consequence the Workmanship exclusion clause operated to exclude indemnity.

[56] *Cementation Piling and Foundations Ltd v Aegon Insurance Co Ltd and Commercial Union Insurance Co PLC* [1995] 1 Lloyd's Rep 97.

concrete panels it was discovered that in a number of places there were gaps and voids between adjacent panels which had permitted sand to escape. Cementation were obliged to carry out works to remedy these matters. It was accepted by the parties that the need for these works arose from defects in design, materials and workmanship. For the most part, gaps in the concrete were filled with bagged concrete. In some places the gap was covered and liquid concrete was poured in a similar manner to the original construction technique. Jet grouting was used to fill smaller voids.

The losses suffered by Cementation fell into three distinct areas. First, rectification of the gaps and/or voids in the walls. Second, the removal of the sand fill from the dock bed and third, grouting and filling behind the walls of the voids from which the sand fill had escaped.

The latter two costs were paid for by Commercial Union under its policy on the basis that those items constituted damage respectively to the dock and the berm. The issue for decision before the Judge was whether the first item was covered by the commercial union's policy or not. The relevant insuring section provided that the insurers would "indemnify the insured for an amount not exceeding the limit of indemnity in respect of physical loss of, or damage to, the property insured howsoever caused … and arising from any cause whatsoever except as hereinafter mentioned".[57] A relevant exclusion clause was that the insurers shall not be liable in respect of:

> … (2) the cost of replacing or rectifying defects in design, materials or workmanship unless the property insured suffers actual loss, destruction or damage as a result of such defects. However, initial costs of introducing improvements, betterments or corrections in the rectification of the design, material or workmanship causing such loss or damage shall always be excluded.[58]

The trial judge said that s 1 of the commercial union policy imposed an obligation upon the insurers to pay the cost of repairing physical damage which occurred to property insured under the policy. The berm had been damaged through the escape of sand through holes in the wall which was intended to contain it. It was impossible to say that the berm had been repaired when the spaces left by the escaping sand had been filled, but the sand used to fill them was bound in its turn to escape because the holes in the wall had not been filled. The costs of remedying the defects in the wall were, therefore, part of the indemnity due from the insurers "in respect of physical damage to the property insured". That conclusion followed from the interpretation of the definition of the risk read alone.

Sir Ralph Gibson who delivered the leading judgment of the Court of Appeal and with whom the other two judges agreed, dismissed the appeal. The outcome of the appeal was dictated by the terms of the policy and in particular the existence of the curiously worded exclusion clause. To say that the insurers shall not be liable for certain costs unless a certain event has happened created a clear inference that if that event has happened then the insurers would be liable. Further, the exclusion clause provided that "additional costs of introducing improvements, betterments or corrections in the rectification of the design materials or workmanship causing such loss or damage shall always be excluded". Sir Ralph Gibson held that the fact that certain additional costs were excluded necessarily implied that there are other costs of rectification, that is the costs involved in rectifying without such improvements, which would be recoverable under the policy. This construction arose from the use of the word "additional" to describe the cost of introducing the improvements, betterments or corrections.[59] The exclusion clause was therefore pivotal in the construction of the ambit of the insuring clause.[60]

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[57] *Cementation Piling and Foundations Ltd v Aegon Insurance Co Ltd and Commercial Union Insurance Co PLC* [1995] 1 Lloyd's Rep 97, 100.

[58] *Cementation Piling and Foundations Ltd v Aegon Insurance Co Ltd and Commercial Union Insurance Co PLC* [1995] 1 Lloyd's Rep 97, 100.

[59] *Cementation Piling and Foundations Ltd v Aegon Insurance Co Ltd and Commercial Union Insurance Co PLC* [1995] 1 Lloyd's Rep 97, 103.

[60] See also *Zurich Australian Insurance Ltd v Regal Pearl Pty Ltd* (2006) 14 ANZ Insurance Cases 61-715, 75,771 [82]; [2006] NSWCA 328 where the Court applied the principle in *Cementation Piling and Foundations Ltd v Aegon Insurance Co Ltd and Commercial Union Insurance Co PLC* [1995] 1 Lloyd's Rep 97, 103 and used the exclusion clause to assist in construing the intended meaning of the insuring clause.

There has not been a consistent application of principle in respect of the exclusion clause for defective workmanship. For example, the conclusion reached in *Graham Evans*,[61] is counterintuitive and at odds with the conclusion reached in *Walker Civil Engineering v Sun Alliance & London Insurance PLC*.[62] Whether a policy responds to a claim may be open to more than one conclusion depending upon the view taken in respect of the extent of the application of the exclusion clause for defective works.

Occurrence and the Four Trigger Theories

In order to determine whether cover under an occurrence-based liability policy is triggered, the law has devised four different trigger theories. They are the exposure theory of coverage; the manifestation theory of coverage; the injury in fact theory of coverage; and, the continuous trigger theory of coverage.

Exposure Theory of Coverage

Under an exposure theory of coverage, a liability policy is triggered whenever there is exposure to an injury – or damage-causing agent during the policy period. Property damage is considered to have occurred on that first exposure so that the deterioration following that exposure is merely the manifestation of the damage that has already occurred requiring repair or replacement. Only the insurance policy in effect at the date of the first exposure is triggered to respond to the loss.[63]

Manifestation Theory of Coverage

Under a manifestation theory of coverage, coverage is triggered at the time the damage to the property becomes apparent. Only the insurance policy in effect on the date of manifestation of the damage is triggered to respond to the loss. The property damage is caused after a period of dormancy. The date of property damage is the date of manifestation.[64]

In first party property damage cases, when loss occurs over the policy periods of successive policies and is not discovered until several years after it commences, the insurer that is on the risk at the time of manifestation is solely responsible for indemnification. The "manifestation of the loss" occurs at the same time that "inception of the loss" occurs for limitations purposes.[65]

Injury in Fact Theory

Under the injury in fact theory, a policy responds if in fact there was damage which actually occurred during the policy period, whether or not anyone was aware of it or could have been aware of it. Where property damage is ongoing or continuous, every policy in effect while the damage continues to occur is triggered to respond to the loss.

Continuous Trigger Theory

Under a continuous trigger theory of coverage, all insurance policies in effect from the date of initial exposure to a damage-causing agent, through any period of progressive or continuous damage, up to the time the damage is discovered, are triggered.[66] In Australia, the continuous trigger theory of

[61] *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772.

[62] *Walker Civil Engineering Pty Ltd v Sun Alliance & London Insurance PLC* (1996) 9 ANZ Insurance Cases 61-311 (and affirmed on appeal in (1999) 10 ANZ Insurance Cases 61-418).

[63] *TBG Inc v Commercial Union Ins Co*, 806 F Supp 1444 (1990).

[64] See *Chemstar Inc v Liberty Mutual Ins Co*, 41 F 3d 429 (1994); *Pines of La Jolla Homeowners Association v Industrial Indemnity*, 5 Cal App 4th 714 (1992) where the policy of insurance under consideration defined occurrence as an "accident … which results in … property damage neither expected nor intended from the standpoint of the insured".

[65] *Prudential – LMI v Superior Court*, 798 P 2d 1230 (Cal 1990); *Home Ins Co v Landmark Ins Co*, 205 Cal App 3d 1388, 1396 (1988) where the policy of insurance under consideration defined occurrence to mean an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the Insured.

[66] *Strauss v Chubb Indemn Ins Co*, 771 F 3d 1026 (2014) (First-party liability) where the policy of insurance under consideration defined occurrence to means "a loss or accident to which this insurance applies occurring within the policy period. Continuous or repeated exposure to substantially the same general conditions unless excluded is considered to be one occurrence"; *Alie v*

coverage has been considered in determining liability in workers compensation liability policies for mesothelioma cases where there has continuous exposure during successive policies of insurance and there is a progressive injury over many years.[67] Australian policies for construction risks insurance are now defining occurrence by reference to continuous exposure.[68] For example, in *Lumley General Insurance Ltd v Port Phillip City Council*,[69] the construction risks policy under consideration defined Occurrence to mean "an event, or continuous or repeated exposure to conditions, which results in loss of and/or damage to and/or destruction of property, provided the Insured neither expected nor intended that such loss would result". Occurrence was similarly defined in the third-party liability section of the policy. This is significant because it would be a factor that the courts may take into account in deciding whether the continuous trigger theory of coverage should be applied to property loss and damage cases.

The controversy can arise from trying to determine whether there has been loss or damage caused by an occurrence during the period of the policy of insurance. This is because there can be a time lag between the occurrence, the manifestation of the loss and damage and the making of the claim under the policy. As a result, an insured may not be able to comply with its obligation to notify its insurer of circumstances that might give rise to a claim. This issue becomes live when property damage does not manifest during the policy period an insured seeks to assert that the policy responds to such damage.[70]

Application of Continuous Trigger Theory to Property Damage Cases

In *Home Ins Co v Landmark Ins Co*,[71] the Court of Appeal found that as between two successive first-party insurers which indemnified a hotel against property loss, the one which was on the risk on the date of the first manifestation of property damage in the form of concrete spalling was liable for the entire claim resulting from the spalling damage, notwithstanding the fact that the problem was continuous, continued beyond the end of the first policy period and extended, in part, into the second policy period.

The concrete "spalling" was caused by defects in the design and construction of the concrete exterior of the building and concrete room balconies in that such structures were improperly reinforced with

Bertrand & Frere Construction Co Ltd (2003) 222 DLR (4th) 687 where the policy of insurance under consideration defined occurrence to mean "an accident including continuous or repeated exposures to conditions neither expected nor intended by the insurer"; *American Employer's Insurance Co v Pinkard Construction Co*, 806 P 2d 954 (1990) where the policy of insurance under consideration defined occurrence to mean "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured". In *Pinkard*, the Policy defined Property Damage arising out of continuous or repeated exposure to substantially the same general condition shall be considered as arising out of one occurrence; *Californian Union Ins Co v Landmark Ins Co*, 145 Cal App 3d 462 (1983) (Continuous exposure but both insurers were jointly and severally liable) where the policy of insurance under consideration defined occurrence to mean an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured; *Gruol Construction Co Inc v Insurance Co of North American*, 11 Wash App 632 (1974) (insurers are joint and severally liable but it was up to the insurers to sort out apportionment between themselves); *Miller v Safeco Ins Co of Am*, 683 F 3d 805 (2012) (first-party liability case); *Plastics Engineering v Liberty Mutual Insurance*, 759 N W 2d 613 (2009) (coverage was not pro rata'd between the insurers as Liberty had failed to specifically include a pro rata clause).

[67] *Orica Ltd v CGU Insurance Ltd* (2003) 59 NSWLR 14, 58–59, 74–75 (Santow JA (dissenting); [2003] NSWCA 331. See also *Vero Insurance Ltd v Power Technologies Pty Ltd* (2007) 5 DDCR 206; [2007] NSWCA 226; *Commonwealth Steel Co Ltd v Certain Underwriters at Lloyds Comprising Syndicate Nos 130, 144, 208, 210, 214, 235, 250, 404, 469, 490, 677 and 870* (2010) 16 ANZ Insurance Cases 61-837; [2010] NSWCA 31 where the Court of Appeal rejected the underwriters' argument that the Court of Appeal's decisions in *Orica Ltd v CGU Insurance Ltd* and *Vero Insurance Ltd v Power Technologies Pty Ltd* had developed a legal rule directed to the response of insurance policies in respect of asbestos-related diseases to the effect that only the first policy in time would respond.

[68] The Allianz Construction Risks defines **Occurrence** to mean an event including continuous or repeated exposure to conditions that results in Personal Injury, Property Damage or Advertising Injury where such injury or damage is neither expected nor intended from the standpoint of the Insured. Occurrence extends to include any intentional act by or at the direction of the Insured which results in Personal Injury if such Personal Injury arises safely from the use of reasonable force for the purpose of protecting persons or property.

[69] *Lumley General Insurance Ltd v Port Phillip City Council* (2013) 18 ANZ Insurance Cases 61-994; [2013] VSCA 367.

[70] See discussion below regarding Occurrence and the four trigger theories.

[71] *Home Ins Co v Landmark Ins Co*, 205 Cal App 3d 1388 (1988).

steel and contained chemical components which when confronted with sea air and sea spray began a continuous and progressive course of deterioration from the date of installation.[72]

The policy defined occurrence to mean "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the Insured".[73]

The Court decided that the date of manifestation and the date of discovery was the same. In the circumstances, the general rule that the date of manifestation determines which carrier must provide indemnity for a loss suffered by its insured. Liability will not be imposed under an all-property insurance policy where damages occur and are apparent before the date the policy takes effect.[74]

The Court also said in obiter that *California Union v Landmark Ins Co*[75] had misapplied the three pre-manifestation cases to hold a post-manifestation carrier jointly and severally liable.

The Court pointed out that "[c]ommon sense tells us that property damage cases, even those involving continuous damage such as the one before us, differ from asbestos bodily injury cases where injury is immediate, cumulative and exacerbated by repeated exposure. We believe the rationale for apportioning liability in the asbestos cases is not a basis to deviate from settled principles of law applicable to this case".[76]

In *American Employer's Insurance Co v Pinkard Construction Co*,[77] Pinkard had installed a roof which had corroded. The corrosion was a continuous, progressive condition which began immediately following the construction of the roof in 1973 and which was caused by the use of a certain fill material. By the time the portions of the roof collapsed 11 years after construction and the corrosion was discovered, the damage was widespread. Here, the damage slowly progressed. And, although not immediately apparent, the evidence showed that progressive and continuous deterioration of the roof infected the integrity of the structure causing actual property damage during the respective policy periods. The insured contended that because the corrosion was a progressive and continuous condition, coverage was triggered under a series of general liability insurance policies. The Court found the fact pattern distinguishable from a situation in which the manifestation theory is usually applied, that is, when tortious conduct sets in motion a process that ultimately causes injury after a period of dormancy.

The policy defined an occurrence as "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured".[78]

The Insurer had argued that the situation at issue constituted one occurrence triggering coverage only when the roof collapsed. The Court agreed that the damage arose from one continuous process. However, none of the language in the policies conditioned coverage upon the resulting damages manifesting themselves during the policy period. Rather, coverage was provided if property damage occurred during the policy period. Property damage triggered coverage when actual damages were sustained.[79] The Insurer argued that damage which begins in one policy period, and continues through several more, is but one occurrence. This was not accepted.

In *TBG Inc v Commercial Union Ins Co*,[80] the plaintiff, TBG, Inc and its predecessors, owned and operated a brake manufacturing plant in Cloverdale, California from 1967 to 1984. From 1965 to 1972,

[72] *Home Ins Co v Landmark Ins Co*, 205 Cal App 3d 1388, 1391–1392 (1988).

[73] *Home Ins Co v Landmark Ins Co*, 205 Cal App 3d 1388, 1391 (1988).

[74] *Home Ins Co v Landmark Ins Co*, 205 Cal App 3d 1388, 1395 (1988).

[75] *Californian Union Ins Co v Landmark Ins Co*, 145 Cal App 3d 462, 477–478 (1983).

[76] *Californian Union Ins Co v Landmark Ins Co*, 145 Cal App 3d 462, 477–478 (1983).

[77] *American Employer's Insurance Co v Pinkard Construction Co*, 806 P 2d 954 (1990).

[78] *American Employer's Insurance Co v Pinkard Construction Co*, 806 P 2d 954, 955 (1990).

[79] *Samuelson v Chutich*, 187 Colo 155; 529 P 2d 631 (1974).

[80] *TBG Inc v Commercial Union Ins Co*, 806 F Supp 1444 (1990).

TBG used hydraulic fluids containing polychlorinated biphenyls (PCBs) in its manufacturing operations. During this period, waste water containing PCBs was periodically discharged from the plant into an adjacent field. As a result, TBG's property and adjacent parcels of land were contaminated with PCBs. During the years between 1966 and 1970, when much of the PCB contamination on the MGM Site occurred, TBG was insured by Commercial Union Insurance Company under five comprehensive general, umbrella, and excess liability insurance policies.

The policies defined an occurrence as "an accident, including injurious exposure to conditions, which results, *during the policy period,* in bodily injury or property damage neither expected nor intended from the standpoint of the insured".[81]

The Court decided that the continuous trigger theory of coverage would be inappropriate in this case because it would require coverage from every insurer of the property from the time the contamination occurred in the late 1960s until the time it was discovered in the early 1980s, despite the fact that, after 1972, there were no new occurrences causing property damage. The Court also rejected the manifestation theory of trigger as being inconsistent with the terms of the policies. The policies provided coverage for property damage that occurred during the policy period, not for property damage that was discovered during the policy period. The Court held that the exposure theory was appropriate in this case.

In *Browder v United States Fidelity & Guaranty Co* (*Browder*),[82] Fletcher had been the owner and general construction contractor of a Motel. Fletcher had purchased a Special Multi-Peril Policy in 1975. In April 1976, after completion of the motel, the Browders purchased the motel. As part of the sale, the policy was assigned to the Browders. In January 1985, the Browders noticed the ceiling of the motel was cracking and sagging. The trial judge held that no loss was recoverable under the policy as no loss had occurred during the relevant policy period. The Court of Appeal held that so long as the damage results from a progressive and continuous condition, an insurer can be held liable even in a situation in which the ultimate injury becomes manifest after the relevant policy term expires. Nevertheless, even though there may have been damage to the property during the period of Fletcher's policy, there could not have been any damage to the Browders because they owned no interest in the motel at that time.[83]

In *Hoang v Assurance Co of America*[84] the Court had to consider a commercial general liability (CGL) insurance policy which insured the homebuilder against liability arising out of the property damage that occurred during the policy period. At issue was whether liability insurance coverage for property damage was voided if the damage occurred when a predecessor in interest owned the damaged property, despite the insured being found legally liable to pay all damages, including those damages owing to property damage. The proceeds of a CGL insurance policy were available to satisfy the judgment of a subsequent purchaser of damaged property against the homebuilder when:

(a) the builder insured itself against liability for damage occurring during the policy period;
(b) the damage to the property occurred during the policy period;
(c) no exclusion to the policy rendered the insured's policy coverage inapplicable because of a change in the property's ownership; and
(d) the builder was liable for the damage to the property.

The Court said that *Browder* differed from this case in two significant respects. First, the insurance policy at issue in *Browder* was a special multi-peril insurance policy, as opposed to the CGL. Additionally, *Browder* involved property the insured owned, a circumstance expressly excluded from the policy's coverage.

In *Alie v Bertrand & Frere Construction Co Ltd*,[85] Bertrand supplied concrete for the construction of about 140 homes in 1986, 1987 and 1988. Bertrand used material known as type C fly ash supplied by

[81] *TBG Inc v Commercial Union Ins Co*, 806 F Supp 1444, 1452 (1990).

[82] *Browder v United States Fidelity & Guaranty Co* 1993 Colo App LEXIS 278.

[83] This decision was affirmed in *Browder v United States Fidelity & Guaranty Co* 893 P 2d 132, 134–135 (1995).

[84] *Hoang v Assurance Co of America* 2007 Colo LEXIS 31.

[85] *Alie v Bertrand & Frere Construction Co Ltd* (2003) 222 DLR (4th) 687.

Lafarge Canada Inc as one ingredient in its ready-mix concrete. The concrete used in the foundations of the homes proved defective and in 1992 it was determined that the foundations needed total replacement. The defect was traced to the use of Lafarge's fly ash. One hundred and thirty-seven homeowners sued Bertrand & Lafarge. Bertrand joined five of its insurers to the proceedings claiming they were obliged to indemnify Bertrand for any damages it owed to the plaintiff. Lafarge also joined 18 of its insurers to the proceedings.

The policies defined an occurrence as "an accident including continuous or repeated exposures to conditions neither expected nor intended by the insurer".[86]

The high levels of sulphates and alkalis in the fly ash supplied by Lafarge caused the concrete to deteriorate, leading to the damages suffered by the plaintiffs and the need for complete replacement of the footings and foundation walls. The deterioration of the foundations had resulted from chemical reactions originating in whole or in part from components of the fly ash. The deterioration took place over time, with exposure to wetting and drying and, in some cases, freezing and thawing. The deterioration had begun shortly after the concrete was placed. The plaintiffs inter alia recovered all of the costs of replacing the foundation walls and footings.

The five Bertrand insurers were obliged to indemnify Bertrand for damages owed to the plaintiffs. Damage had occurred from 1986, when the first foundations were poured, to 1992 when it was determined that the foundations had to be replaced. Each of the five policies in effect for any of the one-year periods between 1986 and 1992 had been triggered.

The damage suffered by the plaintiffs whose foundations were poured in 1986 were apportioned equally over the seven policy periods from 1986 to 1992. Damages suffered by those whose foundations were poured in 1987 were spread equally over the six policy periods running from 1987 to 1992 and damages referable to the houses whose foundations were poured in 1988 were spread equally over the five policy periods from 1988 to 1992.

Some of the Lafarge insurers were obliged to indemnify Lafarge for the damages suffered by the plaintiffs. The Court quantified the liability of the individual insurers using the same pro rata approach that had been used to quantify the liability of the Bertrand insurers. On this approach, five of the Lafarge insurers (who had been on risk at the time that the damage had been suffered) were ultimately held liable to indemnify Lafarge.

On appeal, the Court of Appeal held that if the injury in fact is found to have occurred at the date of exposure to the hazard, at the date of manifestation of the damage, or on a continuous and progressive basis, one might refer to the application of the exposure, manifestation or continuous trigger theories as descriptive of the timing of the damage as it actually occurred. However, the most straightforward and accurate nomenclature in each case is injury in fact.[87]

If the full extent of the damage had become a certainty at a point in time before it is discovered, the injury in fact has occurred by that point in time. Consequently, the fact that there may be further deterioration after that point does not trigger any policies in place after that point, because the damage is already complete. It will be a matter of evidence at the trial as to when the damage became complete. The point when the full extent of the damage becomes known is the manifestation date. In this case, there was no evidence acceptable to the trial judge that the damage was complete before the experts did conclusive testing in 1992. Therefore, that date was accepted as the date when the damage became complete.[88]

Because it was not possible on the evidence to determine how much of the damage occurred during any particular policy period, the application of the continuous trigger theory was appropriate in order to allow the trial judge to apportion the damage on a pro rata basis through the affected policy periods.[89]

[86] *Alie v Bertrand & Frere Construction Co Ltd* (2003) 222 DLR (4th) 687, [59].

[87] *Alie v Bertrand & Frere Construction Co Ltd* (2003) 222 DLR (4th) 687, [141].

[88] *Alie v Bertrand & Frere Construction Co Ltd* (2003) 222 DLR (4th) 687, [142].

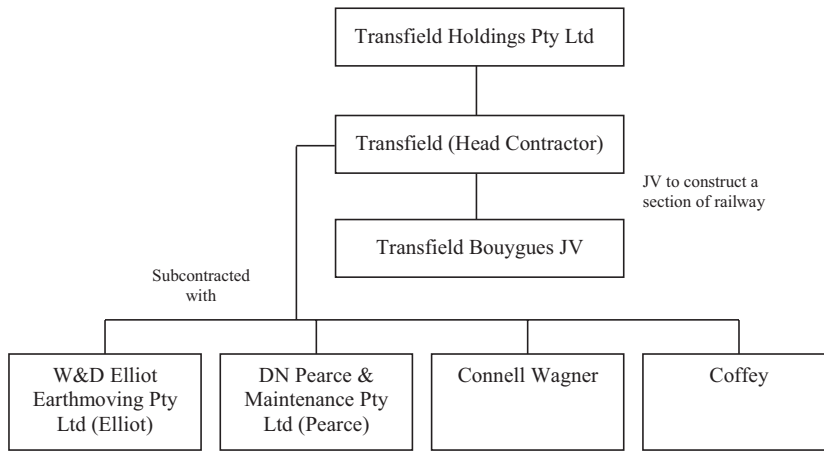
[89] *Alie v Bertrand & Frere Construction Co Ltd* (2003) 222 DLR (4th) 687, [143].

Cross Liability Clauses

Contract Works policies have cross liability clauses.[90] The commercial objective behind such a clause is to enable all participants in a construction project with an insurable interest to be insured so that every tradesperson can work towards the common goal of completing the project rather than fighting between themselves to determine responsibility for any property damage arising from the negligence of any of them.[91] The courts have also found such a clause significant in their construction of the policy as to whose property is insured under the policy.

In *Transfield Pty Ltd v National Vulcan Engineering Insurance Group Ltd*[92] the underwriters agreed to insure Transfield Holdings Pty Limited and all subsidiary and controlled joint venture companies, their subcontractors and all principles under a contractor's floater policy. The policy had three sections. Section A provided insurance for loss or damage to property owned by the insured or for which the insured may have been responsible. Section B covered legal liability under the terms of any contract maintenance or defects liability clauses for loss and/or damage in identified circumstances. Section C set out various terms and conditions.

The following table sets out the relationship between the parties to the proceedings.



[90] For example, the Suncorp wording in its construction insurance annual policy provides: "(a) the word 'Insured' shall apply to each organisation or person comprising the Insured in the same manner as if a separate Policy had been issued to each of them. (b) the Insurers' total liability in respect of all parties comprising the Insured shall nevertheless not exceed the Sums Insured and/or Limits of Liability stated in the Schedule."

[91] *Transfield Pty Ltd v National Vulcan Engineering Insurance Group Ltd* (2003) 12 ANZ Insurance Cases 61-547, 76,436; [2002] NSWSC 830 where McClellan J described the purpose of the policy in these terms: "The purpose of the policy of insurance was plainly to provide insurance to Transfield and other parties involved with relevant Transfield projects. Although separate policies could have been issued this had obvious practical difficulties. By issuing one policy, which contained a cross-liability clause, the relevant parties could each be insured by a policy which responds to any particular claim made by a party. The commercial objective has been described elsewhere in these terms. … 'On any construction site … there is ever present the possibility of damage by one tradesman to the property of another and to the construction as a whole. Should this possibility become reality, the question of negligence in the absence of complete property coverage would have to be debated in Court. By recognising in all tradesmen an insurable interest based on that very real possibility, which itself has its source in the contractual arrangements, opening the doors of the job site to the tradesmen, the Courts would apply to the construction field the principle expressed so long ago in the area of bailment. Thus all the parties whose joint efforts have one common goal, eg the completion of the construction, would be spared the necessity of fighting between themselves should an accident occur involving the possible responsibility of one of them' *Commonwealth Construction Co Ltd v Imperial Oil Ltd* (1977) 69 DLR (3d) 558 at 562-63."

[92] *Transfield Pty Ltd v National Vulcan Engineering Insurance Group Ltd* (2003) 12 ANZ Insurance Cases 61-547; [2002] NSWSC 830.

Two floods occurred during the construction of the project. As a result of the first and/or second incidents, a dredge belonging to Pearce was damaged, a caterpillar excavator belonging to Elliot was damaged and a part of the cofferdam, sheet piling and certain plant and equipment belonging to Transfield was damaged. Various claims were also made against Transfield, Connell Wagner and Coffey for compensation for loss and damage.

The following claims for compensation for "loss of and/or damage to and/or destruction of property and/or loss or use thereof" within the meaning of section C of the policy were made:

(a) Pearce claimed against Transfield, Connell Wagner and Coffey;
(b) Elliot claimed against Transfield, Connell Wagner and Coffey;
(c) Transfield claimed against Connell Wagner and Coffey;
(d) Connell Wagner claimed against Coffey and Transfield; and
(e) Coffey claimed against Connell Wagner and Transfield.

Connell Wagner and Coffey denied all liability and responsibility for the first and second incidents and the quantum of all claims made by all parties made against them. The underwriters invoked exclusion 3(b)[93] of the policy to deny indemnity to Connell Wagner and Coffey in respect of their alleged liability to Transfield. At issue was the construction of the exclusion clause and the operation of the cross liability and waiver of subrogation clause.[94]

McClellan J said that each party was to be considered as a separate insured entity as if a separate policy had been issued to each of them.[95] The insuring clause provided that the Insurer will pay all sums which the Insured shall become legally obligated *to pay* in certain circumstances. The Insurer in this context must be a reference to the party which has the obligation to make the payment and will be the party which makes the claim. The exclusion clause can only operate in relation to that claim and it follows that the Insured referred to in the exclusion clause must be the party making the claim.[96] The insurer was therefore precluded from relying upon the exclusion clause to deny indemnity to Connell Wagner and Coffey in respect of their liability to Transfield.

Waiver of Subrogation

Pursuant to a contract of insurance, an insurer has the right to be subrogated – exercise the rights of the insured against the third parties – once it has indemnified the insured for the claim. Some contracts modify this principle and provide that the insurer may be subrogated to the rights of the insured when it makes a part payment under the policy in the insured's favour.

The right of subrogation allows the insurer to commence recovery action against third parties in the shoes of the insured to recover the loss of the insured. The obligation of the insurer when it commences a subrogated recovery action is to pursue the third party for the whole of the insured's loss even if part of that loss is uninsured. It is up to the insurer to come to an arrangement with the insured as to legal costs.

[93] This section shall not apply to liability: "(b) for damage to property owned by the insured."

[94] "Each of the persons comprising the Insured shall for the purposes of this policy be considered a separate and distinct unit and the words 'the Insured' shall be considered as applying to each of such persons in the same manner as if a separate policy had been issued to each of them in his name alone and the Insurers waive all rights of subrogation or action which they may have or acquire against any of such persons. Provided that nothing in this clause shall be deemed to increase the limit of the Insurers' liability under this policy in respect of any one occurrence."

[95] *Transfield Pty Ltd v National Vulcan Engineering Insurance Group Ltd* (2003) 12 ANZ Insurance Cases 61-547, 76,436; [2002] NSWSC 830.

[96] *Transfield Pty Ltd v National Vulcan Engineering Insurance Group Ltd* (2003) 12 ANZ Insurance Cases 61-547, 76,436; [2002] NSWSC 830.

In *GPS Power Pty Ltd v Gardiner Willis & Associates Pty Ltd*,[97] the Queensland Court of Appeal had to construe the definition of "the insured"[98] and the clause relating to subrogation.[99]

The Queensland Court of Appeal construed the waiver of subrogation rights clause very broadly by giving it its ordinary meaning and not reading it down to achieve "a more acceptable commercial result". By majority, the Court said that A and B need not be each insured under the same policy of insurance with respect to a loss in order for the waiver of subrogation clause to operate. As a matter of construction, the waiver extended to each insured under the policy irrespective of whether they were insured in respect of the loss under that policy. Otherwise, "it would be meaningless for the insurer to think in terms of subrogation with respect to a claim against B consequent upon paying out a claim made by A. B would be entitled, if such a claim was made, to say that the insurer was obliged to indemnify it with respect to the loss".[100] The waiver of subrogation clause was therefore not commensurate with cover.

This judgment has been applied in the New South Wales courts in the case of *Larson-Juhl v Jaywest*.[101] Handley J affirmed the decision of Master Macready and said that "the duty of this Court is to construe the language of the clause fairly and simply without making any extensive or extravagant implication. Under the clause the insurer agrees that it 'shall waive any rights and remedies or relief' and there is nothing to confine the generality of these words. … this Court should give the clause its ordinary meaning and if this is done it covers the causes of action pleaded by the Appellant".[102]

In *Standard Publishing House (Aust) Pty Ltd v Chen*,[103] the NSW Supreme Court had to determine whether or not the defendant was a "co-insured" under the relevant policy for the purposes of defeating a subrogated claim brought by the insurer. Standard Publishing House (the **lessee**) leased premises from Chen (the **lessor**) for the purposes of its printing businesses. On three separate occasions during 2008, rainwater entered the premises and caused damage to the lessee's printing machinery and stock. The insurer (**Allianz**) indemnified the lessee for the damage caused by the first and third incidents. Allianz commenced proceedings in the name of the lessee, seeking damages from the lessor in respect of those two incidents.

The waiver of subrogation clause in the policy stated that the insurer waived its "rights and remedies or relief to which We may or may not become entitled by subrogation against: i) any co-insured (including directors, officers and employees)". McDougall J looked to s 8 of the policy which stated that the "insured" was to include parties "to whom the Named Insured is obligated by virtue of any contract or agreement to provide insurances such as is afforded by this Policy". As a matter of construction of the policy, the lessor was a party to which s 8 applies. McDougall J said that the waiver of subrogation clause should not be limited so as to be "commensurate with the cover". While the lessor was only

[97] *GPS Power Pty Ltd v Gardiner Willis & Associates Pty Ltd* [2001] 2 Qd R 586; [2000] QCA 495.

[98] "'The Insured' shall include: (a) the parties nominated in the Schedule; (b) all other principals and/or owners of the site of the Works; (c) all contractors and sub-contractors (which shall include all other lower tier subcontractors), but only to the extent of their activities in connection with the Insured Operations and their interest therein; (d) any supplier or manufacturer of plant and materials to be incorporated in the Works, but only to the extent their activity as a contractor or sub-contractor in connection with the Insured Operations and then only to their interest, but only where the Principal contracts to insure their respective interests under this Policy; (e) … (f) any director, executive director, employee or agent of the Insured parties, whilst acting within the scope of his or her duties with such parties; (g) any unnamed party being of other category than specified under (a) and (f) above, having an insurable interest in the Insured Operations and/or Insured Property. This definition of 'the Insured' shall exclude consultants but only in respect of such consultants' professional duty of care to other persons and/or parties included in this definition of 'the Insured'."

[99] "(a) Upon the payment of any claim under this Policy, subject to any restrictions imposed by the Commonwealth *Insurance Contracts Act 1984*, the Insurers shall be subrogated to all the rights and remedies of the Insured arising out of such claim against any person or corporation whatsoever. (b) … (c) In the event of the Insurers indemnifying or making a payment to any Insured(s), the Insurers shall not exercise any rights of subrogation against any other Insured(s) hereunder. (d) The Insurers agree to waive any rights and remedies or relief to which they may become entitled by subrogation against: (i) any corporation or organisation (including its directors, officers, employees or servants) owned or controlled by the Insured named in para(a) of The Insured definition herein; (ii) any Insured named or described by this Policy (including its directors, officers, employees or servants)."

[100] *GPS Power Pty Ltd v Gardiner Willis & Associates Pty Ltd* [2001] 2 Qd R 586, [44], [47]; [2000] QCA 495.

[101] *Larson-Juhl v Jaywest* (2001) 11 ANZ Insurance Cases 61-499; [2001] NSWCA 260.

[102] *Larson-Juhl v Jaywest* (2001) 11 ANZ Insurance Cases 61-499, 75,787; [2001] NSWCA 260.

[103] *Standard Publishing House (Aust) Pty Ltd v Chen* (2012) 17 ANZ Insurance Cases 61-951; [2012] NSWSC 1544.

afforded cover under s 8 of the policy and was not entitled to cover for the subject claim, the lessor was an "insured" under that section which meant that it was also a "co-insured" for the purposes of the waiver of subrogation clause. The lessor was therefore entitled to be indemnified and the subrogated claim brought by Allianz was rejected.

It is convenient to note that the approach taken by the courts in New South Wales and Queensland diverges from the two-step approach of the courts in the United Kingdom. The prevailing approach taken there is that where there is an express waiver of subrogation in a contract of insurance then the waiver is commensurate with the cover.[104] However, where the express waiver of subrogation does not cover the scope of the claim, a construction of the underlying contract terms may lead to the conclusion that the parties had objectively intended to waive their rights of subrogation against each other.[105]

Circuity of Action

In *Larson-Juhl v Jaywest*,[106] Master Macready in obiter said that the defence of circuity of action is available whenever the rights of the competing litigants is such that the defendant would be entitled to recover back from the plaintiff the same amount which the plaintiff seeks to recover from the defendant whether those sums are categorised as debts, or damages.[107] The elements of the defence are that (a) it must be shown that precisely the same amount of damages would be awarded in the defendant's proposed action as in the plaintiff's action; (b) both the plaintiff and the defendant must be suing each other in the same right; (c) both actions must be actions at law, not one in law and one in equity; and (d) either the cause of action must be complete, or alternatively, the defendant so obviously has an action as a result of the finding for the plaintiff that it would be scandalous to put the defendant to the trouble of starting a fresh action.[108] However, the defence would have failed as any amount that the defendants could have claimed on the policy of insurance for their loss of profit would have been in a different amount to that of the plaintiff's claim.[109]

Miscellaneous Issues – Failure to Note an Insured

In *Thiess Contractors Pty Ltd v Norcon Pty Ltd*,[110] the issue was whether a plaintiff who had suffered loss as a result of a defendant's negligence, but is the beneficiary of an insurance policy covering that loss should have the sum that it has received from the insurer taken into account to reduce the damages recoverable from the defendant.

A workman had been injured at a construction site when he tripped over a piece of uncapped reinforcing steel and injured his spine. He contended that the accident was caused by the negligence of his employer.

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[104] *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582 (QBD), 613 (Colman J).

[105] See Dr Özlem Gürses, "Subrogation Against a Contractual Beneficiary: A New Limitation to Insurers' Subrogation?" [2017] *Journal of Business Law* 557 where the author carried out a very detailed review of the law in relation to subrogation and sets out the series of issues (p 574) that has to be considered in determining whether an insurer is entitled to bring a subrogated claim against a co-insured. In particular, 1. Does the insurance contract contain a subrogation waiver clause? (a) Yes – no subrogation against contractual beneficiary (who may or may not be co-assured). (b) No – refer to the underlying contract. 2. Does the underlying contract provide a joint insurance clause? (a) Yes – subrogation right cannot be exercised against the co-assured. (b) No – refer to the underlying contract as it may still contain an insurance provision albeit not expressly a joint insurance. 3. Does one party to the underlying contract agree to insure his interest? (a) Yes – depending on the interpretation of the party's intention, it is likely that this insurance will be interpreted for the benefit of the defendant as well as the assured. (b) No, the contract is silent – it will ultimately be the interpretation of the underlying contract but it is likely in this case that there is nothing in the contract precluding the insurer from exercising his rights of subrogation. 4. In 2(a) and 3(a) above, if the defendant to a subrogation action paid the premium, it may be taken as an indication that the parties agreed to claim the loss from the insurer but not from each other. However, the premium payment clause is a persuasive matter but not determinative on its own.

[106] *Larson-Juhl v Jaywest* (2001) 11 ANZ Insurance Cases 61-472; [2001] NSWCA 260.

[107] *Larson-Juhl v Jaywest* (2001) 11 ANZ Insurance Cases 61-472, 75,404 [8], 75,411 [49]; [2001] NSWCA 260.

[108] *Larson-Juhl v Jaywest* (2001) 11 ANZ Insurance Cases 61-472, 75,411–75,412 [50]; [2001] NSWCA 260.

[109] *Larson-Juhl v Jaywest* (2001) 11 ANZ Insurance Cases 61-472, 71,412 [51]; [2001] NSWCA 260.

[110] *Thiess Contractors Pty Ltd v Norcon Pty Ltd* (2001) 11 ANZ Insurance cases 61-509; [2001] WASCA 364.

He subsequently commenced proceedings against his employer claiming damages. Thiess Contractors and Norcon Pty Ltd were joined as defendants to the action. Thiess Contractors was the occupier of the site and the main contractor for the purposes of the construction work being performed there. The respondent was one of the subcontractors of Thiess Contractors. It was responsible for the installation of the reinforcing steel and the workman alleged that it too was negligent.

Thiess Contractors had issued a Contribution Notice against Norcon alleging that it was a term of the subcontract between it and Norcon that Norcon would at its own expense, procure and maintain an insurance policy in the joint names of Thiess and Norcon and others, covering liability in respect of personal injury to any person where the injury arises out of or is caused by the execution of the subcontract works. Thiess Contractors alleged that the respondent was in breach of that term and that it had failed to procure the proposed policy. In its defence, Norcon said that as Thiess Contractors was the beneficiary of another policy, it had suffered no loss. as Thiess Contractors had lost the benefit of the policy of insurance.[111]

PROFESSIONAL INDEMNITY POLICY

A contractor's all risk policy excludes cover for professional negligence. A professional indemnity policy provides cover for legal liability to pay damages in respect of claims that were made against the insured and notified to the insurer during the policy period arising from a failure to exercise reasonable care and skill in the provision of its professional services.[112]

Nexus between the Legal Liability and the Business of the Insured

The legal liability must arise from or be in connection with the professional services of the insured as defined in the policy. The negligence has to be in connection with the business of the insured.[113] In *Hurlock v Johnstone Shire Council*,[114] the issue was whether the insured Council had negligently subdivided and sold flood prone land. The insured had sought indemnity from the local government insurance scheme.[115] The Council contended that there was a "negligent act, error or omission" on its part with respect to the design and construction of the subdivision. The proceedings had settled but the Council had to demonstrate that the policy responded to the claim. On the pleadings, negligence with respect to the design and construction of the subdivision had not been an issue for determination. However, the Court said that as there was negligence by the respondent with respect to the design and construction of the subdivision there was a valid claim pursuant to the professional indemnity provision.[116]

Ascertainment of Legal Liability

What constitutes legal liability? Legal liability is ascertained via judgment, arbitration, award or by agreement.[117] The basic proposition is that a judgment is conclusive evidence of legal liability.[118]

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[111] *Thiess Contractors Pty Ltd v Norcon Pty Ltd* (2001) 11 ANZ Insurance cases 61-509, 75,915 [17]; [2001] WASCA 364. This has been applied in *Clambake Pty Ltd v Tipperary Projects Pty Ltd (No 3)* (2009) 77 ATR 242, [493]; [2009] WASC 52.

[112] The key elements of a typical insuring clause for a professional indemnity that have to be satisfied in any claim for indemnity have been highlighted and will be explored below.

[113] *Smart v AAI Ltd* [2015] NSWSC 392; *Hurlock v Johnstone Shire Council* [2002] QCA 256, [34]–[35].

[114] *Hurlock v Johnstone Shire Council* [2002] QCA 256.

[115] The Business of the Council had been defined as: "Municipal or other Local Government Authorities, and all incidental and associated functions of The Member (including … community housing scheme (also known as the Low Cost Housing Rental Scheme) … and the like services)."

[116] *Hurlock v Johnstone Shire Council* [2002] QCA 256, [35].

[117] *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363; *Edwards v Insurance Office of Australia Ltd* (1934) 34 SR (NSW) 88; *Penrith City Council v Government Insurance Office (NSW)* (1991) 24 NSWLR 564; *Bradley v Eagle Star Insurance* [1989] 1 AC 957 (which approved *Post Office v Norwich Union Fire Insurance Society Ltd*).

[118] *Parker v Lewis* [1873] LR 8 Ch 1035, 1059–1060 where it was held in the context of a bond of indemnity that a judgment is conclusive evidence of legal liability. *Parker v Lewis* was approved in *Edwards v Insurance Office of Australia Ltd* (1934) 34 SR (NSW) 88, 94.

However, a judgment may not be conclusive of legal liability if it is a consent judgment[119] or there has been a failure to run a proper defence.[120] A consent judgment is treated as a compromise or a settlement of the proceedings.

Where an insured has settled the claim against it, the prevailing view in Australia is that where an insurer has wrongfully repudiated a contract by denying indemnity, an insurer is bound by a reasonable settlement determined on an objective basis[121] at the time of settlement.[122] Once a settlement is shown to be reasonable then it will satisfy the requirements of causation and remoteness.[123] An insured does not have to prove underlying liability to the claimant via extrinsic evidence.[124]

Legal reasonableness may coincide with commercial reasonableness but the two are not necessarily coextensive. An outstanding commercial settlement will not necessarily be legally reasonable.[125]

Demonstrating reasonableness requires proof not only that the result was reasonable but also that the negotiations were conducted with proper care and skill. The settlement amount must reflect the relevant party's true prospects of success on the basis that the proceeding had been conducted with care and skill because otherwise it would merely reflect that party's impaired prospects. The risk involved in the litigation and the reasons which led to the settlement are the factors that will determine whether or not the settlement amount was reasonable.[126] Evidence of the advice which the insured received to induce it to accept the settlement is not proof in itself of the reasonableness of the settlement advised. The factors which lead to the giving of the advice are factors relevant to the reasonableness of the settlement. The relevance of advice given by the insured's legal advisers to settle is that it tends to negative the hypothesis that the insured acted unreasonably in accepting the settlement.[127]

Ultimately, there is no single answer to the question of what will constitute a reasonable settlement amount. That question requires consideration of the chances of the parties succeeding in their respective

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[119] *Hurlock v Johnstone Shire Council* [2002] QCA 256, [29].

[120] See *Hurlock v Johnstone Shire Council* [2002] QCA 256, [31] where: "A reading of those cases [*Unity Insurance Brokers, Biggin & Co v Permanite Ltd* [1951] 1 KB 422; *Distillers Co (Bio-Chemicals) (Aust) Pty Ltd v Ajax Insurance*; *Edwards v Insurance Office of Australia*; *QBE Insurance v QBE Insurance*] convinces me that the compromise is binding or the insurer in circumstances such as these [where the insurer in full knowledge, has stood by and allowed the insured to conduct the defence], unless it is demonstrated that the compromise was unreasonable or that there was some other valid defence available to it in the proceedings brought by the insured."

[121] *HIH Casualty & General Insurance Ltd v Turner* (1998) 72 SASR 399; *Hurlock v Johnstone Shire Council* [2002] QCA 256; *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603; [1998] HCA 38; *BNP Paribas v Pacific Carriers Ltd* [2005] NSWCA 72; *Komatsu Marketing Support Australia Pty Ltd v Marsh Pty Ltd* [2012] NSWSC 163, [15]; *BHP Billiton (Olympic Dam) Corp Pty Ltd v Steuler Industriewerke GmbH (No 2)* [2011] VSC 659.

[122] *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603, [7] (Brennan CJ), [130] (Hayne J); [1998] HCA 38.

[123] *Rhyse Holdings Pty Ltd v Stanton Hillier Parker (Qld) Pty Ltd* [2002] QCA 122; *Hurlock v Johnstone Shire Council* [2002] QCA 256; *BNP Paribas v Pacific Carriers Ltd* [2005] NSWCA 72; *Rail Corp New South Wales v Fluor Australia Pty Ltd* [2009] Aust Torts Reports 82-038; [2009] NSWCA 344. *BHP Billiton (Olympic Dam) Corp Pty Ltd v Steuler Industriewerke GmbH (No 2)* [2011] VSC 659, [228].

[124] *Broadlands Properties Ltd & Broadlands Estates Ltd v Guardian Assurance Co Ltd* (1984) 3 ANZ Insurance Cases 60-552, 78,321; *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd* (1993) 7 ANZ Insurance Cases 61-172, 77,975–77,976, *Baulderstone Hornibrook Engineering Ltd v Gordian Runoff Ltd* (2006) 14 ANZ Insurance Cases 61-701; [2006] NSWSC 223 and *Limit (No 3) Ltd v ACE Insurance Ltd* (2009) 15 ANZ Insurance Cases 61-823; [2009] NSWSC 514.

[125] *Protec Pacific Pty Ltd v Steuler Services GmbH & Co KG* [2014] VSCA 338, [756].

[126] *Protec Pacific Pty Ltd v Steuler Services GmbH & Co KG* [2014] VSCA 338, [747] approving the principle in *BNP Paribas v Pacific Carriers Ltd* [2005] NSWCA 72, [17] and *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603, 616 [35] (McHugh J), 653 [129] (Hayne J); [1998] HCA 38. For a discussion on the evidence required to prove reasonableness of settlement, see *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd*, 653, 655 (Hayne J).

[127] *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603, [6] (Brennan CJ); [1998] HCA 38. See also at 616 [35] (McHugh J) where his Honour held that "in most cases where the settlement is made on legal advice, the evidence of the relevant legal advisers is vital. This is because the risk involved in the litigation and the reasoning which led to the settlement are the factors that will determine whether or not the settlement was reasonable. If an unreasonable settlement is made on bad legal advice, the innocent party's remedy is against the legal adviser, not the contract breaker".

claims or defences. As prediction of likely outcomes in litigation is imperfect and imprecise, in each case there will be a range within which a settlement amount will be reasonable.[128]

What Is a Claim?

A claim is a written demand for compensation.[129] A claim for civil compensation can include a claim for equitable compensation.[130] However, a claim for civil damages or civil compensation does not include a claim in debt. A claim also does not encompass a claim for restitution, or for a civil penalty.[131] The civil liability that is ultimately established need not precisely correlate with the claim that was first made and notified. This arises from the use of phrases like "in respect of claims" or "as a result of claims" in the insuring clause.[132] The nature of the liability that has been established has to be characterised. Civil liability in respect of negligence, breach of contract and misleading or deceptive conduct will be covered if it falls within the terms of the policy.[133] This is determined by reference to the facts that give rise to the liability rather than the form of the liability.[134] However, it does not matter how the claim is conveyed. For example, it can be via correspondence, a statement of claim or via arbitral process.

Claim vs Circumstances

There is a distinction between a claim and a circumstance that might give rise to a claim. The policy may include a notification of circumstances clause which invites the insured to notify the insurer of circumstances that reasonably might give rise to a claim. If the policy does not have such a clause then s 40(3) of the *Insurance Contracts Act 1984*[135] enables an insured to notify the Insurer of circumstances. The effect of such notification is that if a claim does eventuate then the policy under which notification of circumstances is made may be extended to provide cover for the later claim that is demonstrated to fall within the circumstances that was notified.[136] The High Court has termed these as "discovery policies".[137] Sufficient notification would be satisfied if an insured provides an Insurer with fulsome and timely notification of circumstances that a reasonable person might expect in the circumstances of each particular case.[138] A causal link is required between the circumstances that were notified and the claim that eventuates.[139]

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[128] *Protec Pacific Pty Ltd v Steuler Services GmbH & Co KG* [2014] VSCA 338, [749], approving *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603, 653 [132]; [1998] HCA 38.

[129] *Junemill Ltd (in liq) v FAI General Insurance Co Ltd* [1999] 2 Qd R 136; *HIH Casualty General Insurance Ltd v Pade* (2001) 11 ANZ Insurance Cases 61-481; [2000] NSWCA 325; *Cassidy v Leslie* [2010] NSWSC 742.

[130] *Amlin Corporate Member Ltd v Austcorp Project No 20 Pty Ltd* (2014) 311 ALR 222, [71]; [2014] FCAFC 78, referring to *Chittick v Maxwell* (1993) 118 ALR 728, 745 where Young J held that it was a question of construction of the policy as to whether the policy covered civil liability to pay equitable compensation and *Kyriackou v ACE Insurance Ltd* (2013) 17 ANZ Insurance Cases 61-973, [57]–[59]; [2013] VSCA 150 where Harper JA considered the issue but did not reach a concluded view.

[131] *Kyriackou v ACE Insurance Ltd* (2013) 17 ANZ Insurance Cases 61-973, [51]–[52] (Harper JA); [2013] VSCA 150, with whom Tate and Kyrou AJA agreed.

[132] *Smart v AAI Ltd* [2015] NSWSC 392, [178]; *Aquagenics Pty Ltd (in liq) v Certain Underwriters at Lloyd's Subscribing to Contract Number NCP106108663* [2017] FCA 634, [60].

[133] *Smart v AAI Ltd* [2015] NSWSC 392.

[134] *Australia & New Zealand Bank Ltd v Colonial & Eagle Wharves Ltd* [1960] 2 Lloyd's Rep 241, 255; *Smart v AAI Ltd* [2015] NSWSC 392, [179].

[135] *Insurance Contracts Act 1984* (Cth) s 40(3) provides: "Where the insured gave notice in writing to the insurer of facts that might give rise to a claim against the insured as soon as was reasonably practicable after the insured became aware of those facts but before the insurance cover provided by the contract expired, the insurer is not relieved of liability under the contract in respect of the claim, when made, by reason only that it was made after the expiration of the period of the insurance cover provided by the contract."

[136] *Timbercorp Finance Pty Ltd (in liq) v Vivian* (2016) 114 ACSR 198, [61]–[62]; [2016] VSC 338; *Gosford City Council v GIO General Ltd* (2003) 56 NSWLR 542; [2003] NSWCA 34.

[137] *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) 204 CLR 641; [2001] HCA 38.

[138] *L'Union Fire Accident & General Insurance Co Ltd v Klinker Knitting Mills Pty Ltd* (1938) 59 CLR 709, 717–718 (Latham CJ), 723–724 (Starke), 726 (Evatt J).

[139] *Junemill Ltd (in liq) v FAI General Insurance Co Ltd* (1996) 130 FLR 85; 9 ANZ Insurance Cases 61-315, 76,491.

Nevertheless, if an insured is aware of circumstances that might give rise to a claim but fails to notify its insurer of these circumstances and a claim eventuates then s 54 of the *Insurance Contracts Act 1984*[140] may operate to overcome the failure of notification. The key is the knowledge of the insured of the existence of circumstances.[141] If circumstances do not exist then s 54 cannot operate to overcome the absence of notification to extend cover under the policy.[142]

Section 54 of the Insurance Contracts Act

Section 54 is remedial in character and its language is to be construed so as to give the most complete remedy which is consistent with the actual language employed and to which its words are fairly open.[143] The purpose behind s 54 is to ameliorate the unfairness of a strict construction of a policy of insurance which would entitle an insurer to refuse to pay a claim, either in whole or in part, because the insured or "some other person" has done some act after the contract was entered into even when the act or omission did not cause or contribute to the loss covered by the insurance. The explanatory memorandum described this situation as "unsatisfactory".[144] Section 54(1) prevents an insurer from refusing to pay a claim in those circumstances. To the extent that the act or omission caused or contributed in part to the loss covered by the insurance then s 54(4) operates to ensure that the insurer pays that part of the loss that gave rise to the claim that was not caused by the act.

In *Maxwell v Highway Hauliers Pty Ltd*,[145] the High Court said that *Antico v Heath Fielding Australia Pty Ltd* established that s 54 takes as its starting point nothing more than the existence of a claim and of a contract the effect of which is that the insurer may refuse to pay that claim by reason of some act which the insured (or someone else) has done or omitted to do after the contract was entered into. Section 54 does not postulate a liability of the insurer to pay the claim that has been made. Section 54(1) does not focus on the legal character of a reason which entitles an insurer to refuse to pay a claim – for example that the claim falls outside a covered risk, that it falls within the ambit of an exclusion clause or there has been non-compliance with a condition. Instead, s 54(1) focuses upon the actual conduct of the insured – on some act which the insured does or omits to do. Section 54 is engaged when the doing of an act or the making of an omission would excuse the insurer from an obligation to pay a claim for a loss actually suffered by the insured.[146]

In *Maxwell*, the insured had entered into a contract of insurance which indemnified the insured against specified loss, damage or liability occurring to or in respect of the insured's fleet of vehicles during the period of insurance. The policy required each driver to undertake psychological testing. Accidents occurred and claims were made in respect of damage caused by each accident. The insurer refused to pay

[140] *Insurance Contracts Act 1984* (Cth) s 54 provides: "**54 Insurer may not refuse to pay claims in certain circumstances** (1) Subject to this section, where the effect of a contract of insurance would, but for this section, be that the insurer may refuse to pay a claim, either in whole or in part, by reason of some act of the insured or of some other person, being an act that occurred after the contract was entered into but not being an act in respect of which subsection (2) applies, the insurer may not refuse to pay the claim by reason only of that act but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act. (2) Subject to the succeeding provisions of this section, where the act could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may refuse to pay the claim. (3) Where the insured proves that no part of the loss that gave rise to the claim was caused by the act, the insurer may not refuse to pay the claim by reason only of the act. (4) Where the insured proves that some part of the loss that gave rise to the claim was not caused by the act, the insurer may not refuse to pay the claim, so far as it concerns that part of the loss, by reason only of the act. (5) Where: (a) the act was necessary to protect the safety of a person or to preserve property; or (b) it was not reasonably possible for the insured or other person not to do the act; the insurer may not refuse to pay the claim by reason only of the act. (6) A reference in this section to an act includes a reference to: (a) an omission; and (b) an act or omission that has the effect of altering the state or condition of the subject-matter of the contract or of allowing the state or condition of that subject-matter to alter."

[141] *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) 204 CLR 641; [2001] HCA 38.

[142] *Gosford City Council v GIO General Ltd* (2003) 56 NSWLR 542; [2003] NSWCA 34; see discussion below.

[143] *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652, 675.

[144] Explanatory Memorandum, *Insurance Contracts Bill 1984* (Cth) [182]. See also, [177]–[181].

[145] *Maxwell v Highway Hauliers Pty Ltd* (2014) 252 CLR 590; [2014] HCA 33.

[146] *Maxwell v Highway Hauliers Pty Ltd* (2014) 252 CLR 590, 597–598 [21]; [2014] HCA 33.

the claims on the basis that each vehicle had been driven by an untested driver. The Insurers conceded at trial that the fact that each vehicle was being operated by an untested driver could not reasonably be regarded as being capable of causing or contributing to any loss incurred by the Insured as a result of each accident. The sole issue was therefore whether s 54(1) was engaged. Section 54 is engaged if an insurer refuses to pay a claim by reason of an act or omission that occurred after the policy was entered into and s 54(2) does not apply to the act or omission. Section 54(1) does not apply to inherent limitations in the claim. For example, s 54(1) does not apply to a claim made outside of the policy period in respect of a claims made and notified policy. In respect of "discovery policies", s 54(1) does not apply to an occurrence that the insured did not become aware of during the period of the policy.[147]

Extent of Cover – Legal Expense

Professional indemnity policies provide cover for civil liability arising from the failure of the professional to exercise reasonable care and skill in the discharge of his retainer. However, issues can arise as to whether the policy of insurance provides cover for legal expenses incurred by the Insured in circumstances where there has not been a claim for civil liability. The answer to this issue is determined by construction of the individual policies.

In *Kyriackou v ACE Insurance Ltd*,[148] the Victorian Court of Appeal had to consider whether the insurer had to indemnify the insured for its legal costs of defending a claim when the claim was never determined on its merits. ASIC had brought proceedings against the insured in respect of an alleged unregistered managed investment scheme. ASIC had not sought civil compensation or damages and the issue was whether the claim was covered by the insuring clause of the professional indemnity policy. The insured's costs liability did not fall within the insuring clause and the definition of "Defence Costs" in the policy. Harper JA said that the ASIC claims were not claims for civil liability of any kind and did not fall within the insuring clause of the policy.[149]

In *Antico v Heath Fielding Australia Pty Ltd*,[150] the issue was whether an insurer was obliged to indemnify an insured under a claims made policy providing indemnity for legal expenses that an insured incurred as a director in circumstances where the insured had not satisfied the condition precedent in the policy of obtaining the consent of the insurer prior to the incurring of the legal expenses. The High Court held that s 54 of the *Insurance Contracts Act 1984* applied to the omission of the insured to seek consent and the insurer was obliged to indemnify the insured.

Exclusion Clauses

Contractually Assumed Liability

Most professional indemnity policies exclude cover for contractually assumed liability. While some insurers are currently providing cover for insured who have contracted out of proportionate liability legislation, it is unclear how long this cover will be available.

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[147] *Maxwell v Highway Hauliers Pty Ltd* (2014) 252 CLR 590, 598 [23]–[24]; [2014] HCA 33. The issue of what constituted an inherent limitation was explored in *Watkins Syndicate 0457 at Lloyds v Pantaenius Australia Pty Ltd* (2016) 244 FCR 5, 17 [40]–[41]; [2016] FCAFC 150. It involves the construction of the constituent words of the policy as well as the characterisation of the essential character of the policy. The latter will be influenced by the former and will involve the identification of the nature and limits of the risks that are intended to be accepted, paid for and covered. The Court however cited the same example as the High Court had to illustrate their point.

[148] *Kyriackou v ACE Insurance Ltd* (2013) 17 ANZ Insurance Cases 61-973; [2013] VSCA 150. The Insuring Clause had provided: "ACE will indemnify the Insured against [all amounts payable by the Insured … as civil compensation or civil damages … including … payments for Defence Costs] arising from any [written demand for, or an assertion of a right to, civil compensation or civil damages arising out of the Firm's Business or a written intimation of an intention to seek such compensation or damages] in respect of civil liability for breach of a duty owed in a professional capacity first made against an Insured during the Period of Insurance." Defence Costs was defined as: "legal costs and disbursements and related expenses reasonably incurred in — (a) defending any proceedings; … incurred by – (i) the Insured with the written consent of ACE after reporting the Claim to ACE."

[149] *Kyriackou v ACE Insurance Ltd* (2013) 17 ANZ Insurance Cases 61-973, [59]; [2013] VSCA 150. Tate JA agreed with Harper JA at [129]. Kyrou AJA in a separate judgment also held that the ASIC claim did not fall within the insuring clause (at [137]).

[150] *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652.

An insured who has contracted out of proportionate liability legislation or who has provided contractual warranties and indemnities may find that they are not insured to the extent that the contractual liabilities that they have assumed are not commensurate with their failure to exercise to reasonable care and skill.

Dishonesty

Professional indemnity policies exclude cover for loss in connection with a claim made against an insured that has been brought about, or are contributed to, by the dishonesty of the insured. A causal connection is necessary between the loss and the dishonesty.[151] There is no universal definition of dishonesty and each case is fact-dependent. Carelessness[152] and incompetence as well as gross negligence are insufficient.[153]

The test of whether conduct is dishonest is an objective one informed by the common sense and experience of the tribunal of fact.[154] However, a deliberately false statement,[155] knowledge that a transaction is unauthorised,[156] deliberate concealment of a matter that an insured knows ought to be disclosed as well as the deliberate preference of an insured's interests over the interests of a client is likely to be found to be dishonest.[157]

An example of dishonest conduct is an engineer signing off on the adequacy of a structural steel inspection at a complex construction site knowing that every requisite element of the structure has not been inspected and tests carried out on questionable materials sampled and tested for physical and analytical properties to enable the formation of such an opinion.

Duty of Utmost Good Faith

Finally, the insured and insurer owe each other a duty of utmost good faith. The concept of utmost good faith has always been present in the law of insurance and predates s 13 of the *Insurance Contracts Act 1984*.[158] The concept of good faith forbids either party to the insurance contract from concealing what he privately knows, to draw the other into a bargain from his ignorance of the fact, and his believing the contrary.[159] If the duty of disclosure is breached then the insurer may avoid the contract. The basis of avoidance is that the risk run is in fact different from what the insurer understood it to be and therefore the insurer has been prejudiced by the non-disclosure because he was not able properly to estimate the risk.[160]

The duty of utmost good faith encompasses notions of fairness, reasonableness and community standards of decency and fair dealing, and may be breached by capricious or unreasonable conduct which falls

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[151] *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579; [2000] HCA 65; *Youyang Pty Ltd v Ellison Morris Fletcher* (2003) 212 CLR 484; [2003] HCA 15.

[152] *Abbey National Plc v Solicitors Indemnity Fund Ltd* (1997) PNLR 306, 316.

[153] *Peters v The Queen* (1998) 192 CLR 493, 503–504 (Toohey and Gaudron JJ); [1998] HCA 7; *Macleod v The Queen* (2003) 214 CLR 230, 242 (Gleeson CJ, Gummow and Hayne JJ); [2003] HCA 24; *Harle v Legal Practitioners Liability Committee* [2001] VSC 219; *Harle v Legal Practitioners Liability Committee* (2003) 13 ANZ Insurance Cases 61-605, 77,302, [30] (Chernov JA, Callaway and Buchanan JJA agreeing); [2003] VSCA 133; *Brereton v Legal Services Commissioner* [2010] VSC 378; *Legal Services Commissioner v Brereton* (2011) 33 VR 126; [2011] VSCA 241.

[154] *McMillan v Joseph* (1987) 4 ANZ Insurance Cases 60-822, 70,054 (Cooke P), 75,056 (Casey J) (Court of Appeal of New Zealand).

[155] *HG & R Nominees Pty Ltd v Fava* [1997] 2 VR 368.

[156] *Crowe v Wheeler & Reynolds* [1988] 1 Qd R 40.

[157] *Harle v Legal Practitioners Liability Committee* [2001] VSC 219.

[158] *Insurance Contracts Act 1984* (Cth) s 13 provides: "(1) A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith. (2) A failure by a party to a contract of insurance to comply with the provision implied in the contract by subsection (1) is a breach of the requirements of this Act. (3) A reference in this section to a party to a contract of insurance includes a reference to a third party beneficiary under the contract. (4) This section applies in relation to a third party beneficiary under a contract of insurance only after the contract is entered into."

[159] *Carter v Boehm* (1766) 3 Burr 1905; 97 ER 1162.

[160] *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, 506.

short of dishonesty.[161] Therefore, while honesty is a necessary element of the duty of utmost good faith, it is not sufficient.[162] The duty of utmost good faith may require an insurer to act in the legitimate interests of an insured as well as its own interests.[163] The duty of utmost good faith will usually require something more than passivity. It will usually require affirmative or positive action on the part of the person owing a duty of it.[164] In *Sharma v Insurance Australia Ltd (t/as NRMA Insurance)*,[165] the Court held that given the state of information the insurer had and the advice that the insurer had received, the insurer had breached it duty of utmost good faith by failing to determine the claim for indemnity within a reasonable time. In this case, reasonable time, was a period of two weeks.[166]

Duty of Disclosure

An insured has a duty of disclosure. This is considered an aspect of the insured's duty of utmost good faith and its obligation to have regard to the legitimate interests of the insurer.[167] An insured must make full disclosure of all material circumstances to the insurer. This is an objective test.

In *CGU Insurance Ltd v Porthouse*, the High Court had to consider whether the second limb of the definition of "known circumstance" in the CGU professional indemnity policy was purely objective or subjective. The barrister had failed to disclose a known circumstance to his insurer because he subjectively did not believe that a claim might eventuate from the circumstance. The definition was however framed in objective terms.[168] The High Court held that the test was purely objective and the subjective opinion of the insured was irrelevant. A reasonable person in the professional position of the insured would have thought that a claim might eventuate from the circumstances and that was sufficient to invoke the operation of the exclusion clause. The fact that the non-disclosure was innocent was irrelevant.

[161] *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* (2005) 146 FCR 447, [88]–[89]; [2005] FCAFC 185, approved in *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1, [15], [128] (Gleeson CJ, Kirby and Crennan JJ); 81 ALJR 1551; [2007] HCA 36; *Hellessey v MetLife Insurance Ltd* [2017] 19 ANZ Insurance Cases 62-152, [49]; [2017] NSWSC 1284; *TAL Life Ltd v Shuetrim* (2016) 91 NSWLR 439, [1] (Beazley P), [2] (Leeming JA), [214] (Emmett AJA); [2016] NSWCA 68; *Kelly v New Zealand Insurance Co Ltd* (1996) 130 FLR 97, 111.

[162] *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1, [15], [130]–[132], [257]; 81 ALJR 1551; [2007] HCA 36; *Speno Rail Maintenance Australia Pty Ltd v Metals and Minerals Insurance Pte Ltd* [2009] WASCA 31, [152].

[163] *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1, [15] (Gleeson CJ and Crennan J); 81 ALJR 1551; [2007] HCA 36.

[164] *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1, [247] (Callinan and Heydon JJ); 81 ALJR 1551; [2007] HCA 36.

[165] *Sharma v Insurance Australia Ltd (t/as NRMA Insurance)* [2017] NSWCA 55.

[166] *Sharma v Insurance Australia Ltd (t/as NRMA Insurance)* [2017] NSWCA 55, [113]. See also the recent case of *Lawcover Insurance Pty Ltd v Muriniti* [2017] 19 ANZ Insurance Cases 62-157; [2017] NSWSC 1557 where the Court had to consider whether Lawcover had acted in bad faith in not pursuing an appeal of a personal costs order made against two practitioners in some long running litigation that had eventually sent their clients bankrupt. The principles in relation to the duty of utmost good faith are set out at [112]–[115].

[167] *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1, [15] (Gleeson CJ and Crennan J); 81 ALJR 1551; [2007] HCA 36.

[168] In *CGU Insurance Ltd v Porthouse* (2008) 235 CLR 103; [2008] HCA 30, the policy under consideration had the following exclusion clause: "We do not cover any of the following Claims (or losses): 6.1 Known Claims and Known Circumstances … (b) Claims (or losses) arising from Known Circumstance, or (c) Claims (or losses) directly or indirectly based upon, attributable to, or in consequence of any such Known Circumstance or Known Claims (or losses). … The phrase 'Known Circumstance' is defined in s 11 as follows: 11.12 Known Circumstance. Any fact or situation or circumstance which: (a) Insured knew before this Policy began or (b) A reasonable person in the Insured's professional position would have thought before this Policy began, might result in someone making an allegation against an Insured in respect of a liability that might be covered by this Policy."