

Insurance Case Note

8 July 2009

Tunnel trouble in the Lion City

Limit (No 3) Limited –v– ACE Insurance Limited [2009] NSWSC 514

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Background

The defendant, ACE Insurance Limited (“ACE”), issued a contract works liability insurance policy to a joint venture (“the JV”) engaged by PowerGrid Singapore Limited (“PowerGrid”), in August 2001. The JV was to design and construct 2 cable tunnels from the Senoko Power Station to Gambas Avenue along Woodlands Avenue 8, in Singapore.

The works resulted in damage to the property of third parties, and some existing PowerGrid tunnels.

PowerGrid and the JV received claims from third parties, and PowerGrid and the third parties sought indemnity from the JV.

The JV sought indemnity from ACE in the first instance, which was denied. The JV then sought indemnity from the plaintiff, a subsidiary of Lloyds (“Lloyds”), under a general and product liability policy.

Lloyds granted indemnity and made payments to the JV totalling S\$13 million, by way of reimbursement for costs incurred by the JV in rectifying the damage. Lloyds then sought “recoupment, indemnity or contribution” from ACE on the basis that the payments made by Lloyds “operated to relieve ACE of its liability” to the JV.

ACE denied that it was liable to indemnify the JV, and hence denied any liability to Lloyds. ACE also denied that Lloyds had any liability to indemnify the JV.

The matter was heard in the Supreme Court of NSW, Equity Division by Rein J.

“Occurrences” leading to damage

1. The tunnel boring machine (“TBM”) commenced the main tunnelling work on 10 March 2002, and became entombed on 7 June 2002 following significant over-excavation of soft “G4” category rock, for which the TBM was not well suited. This was known as “TBM/G4 problem”.
2. The TBM subsequently encountered an intrusion of volcanic rock, or “dyke”, the excavation of which allowed water to flow into the tunnel leading to settlement of soil in the vicinity, and damage to property. This was known as the “TBM/dyke problem”.
3. A shaft was excavated at Woodlands Avenue to gain access to the tunnel beneath. The walls of the shaft were improperly waterproofed which allowed water to enter the shaft and the excavation below, causing subsidence of surrounding soils. This was known as the “Woodlands shaft problem”.
4. The same problem occurred at a shaft known as the “Gambas shaft”, although causing less damage. This was known as the “Gambas shaft problem”.

The following insurance law issues are addressed:

1. What is the definition of “legal liability”?
2. What kind of damage is covered by a “maintenance period”?
3. How is a contract to be construed when an ostensible contradiction exists in the terms?
4. How are “professional services” exclusions to be construed?
5. What is the effect on liability arising from 2 or more causes, one of which is excluded?
6. What is an “occurrence”?
7. How are “difference in conditions” clauses to be construed?
8. How are “reasonable precautions” conditions to be construed?
9. Dual insurance.

1. Had the JV incurred a “legal liability”?

The ACE policy required that ACE pay to or on behalf of the JV “all sums which the insured shall become legally liable to pay for any compensation”. ACE asserted that the JV had not incurred any “legal liability” because no judgment or formal settlement had been entered. Therefore, no liability to indemnify arose for either of ACE or Lloyds.

Lloyds argued that the need for a judgment or formal settlement was precluded by the JV acknowledging its liability to the claimants by carrying out works at its cost to rectify the damaged buildings and infrastructure.

ACE relied on *Penrith City Council –v– Government Insurance Office (1991)* to support its contention that no liability to indemnify the JV arose until a judgment or formal settlement was entered against the JV. His Honour found ACE's reliance on this case to be misguided on the grounds that it dealt with a different kind of policy and different circumstances. His Honour found that JV's "legal liability" arose when the JV became liable to the third parties, notwithstanding that the quantum of the liability could not be determined at that stage. By extension, the repair work undertaken by the JV was a form of compensation found to be in lieu of monetary payment, and precluded the need for court proceedings.

HELD: Where the insured rectifies damage, precluding the need for court proceedings, this will satisfy the requirement of "legal liability" although the liability cannot be quantified at that time.

2. Was the damage sustained within the ACE policy period?

The period of insurance of the ACE policy was defined in the policy as the period between 17 April 2001 and 27 May 2003 (24 months), followed by a further 24 month "maintenance period". Lloyds argued that ACE was liable for all damage sustained during both the works and maintenance periods, being 4 years.

His Honour held that this was not the case, and that the damage must occur within the 24 month period of works, unless caused by something done within the following maintenance period. Damage arising during the maintenance period, but caused by something done during the principal works period, was not covered.

HELD: To be covered, the "damage must occur within the 24 month period of works unless the damage has been caused by something done within the maintenance period"¹. This finding seems curious without the benefit of reference to the policy wording, as "maintenance period" cover is normally to indemnify the insured for damage arising from the works period, but which manifests during the maintenance period.

3. What was the effect of general clause 14 in the ACE policy?

ACE contended that the liability to PowerGrid of the JV was excluded by the operation of the professional services exclusion ("PSE") in the ACE policy, which provided that the policy did not respond to liabilities arising from "the rendering of or failure to render professional services".

Lloyds on the other hand, contended that this exclusion was swept away by general clause 14 ("GC14") to the ACE policy which expressly provided cover for damage "in connection with or arising from vibration, or by the removal or weakening of support, or any negligent act of the insured". This clause carried an endorsement in the following terms:

"The clauses contained in this special endorsement shall not in any way be deleted, altered or amended by other provisions in the policies and any other subsequent endorsements and where contradiction arises, this special endorsement shall prevail."

On the approach of His Honour, the liability to PowerGrid of the JV (which was otherwise excluded by the PSE) was protected by GC14, being a clause which PowerGrid expressly required the JV to include in the policy, as required by the works contract.

This construction was reached with reference to the benchmark Singapore case of *Zurich Insurance (Singapore) Pty Limited –v– B-Gold Interior Design & Construction Pty Ltd [2008]*,

a judgment of the Court of Appeal of Singapore.

The court in the *Zurich (Singapore)* matter made provisions for taking into account extrinsic evidence in the construction of contracts. This led his Honour to read the words "liability for" into the general clause, to serve the purpose of the policy as a public liability policy, given that the circumstances suggested this to be the commercial purpose of the policy as intended by both PowerGrid and the JV.

HELD: The policy was to be construed with reference to the commercial purpose of the policy as evidently intended by the parties to the insurance contract.

4. What was the effect of the professional services exclusion ("PSE")?

As noted above, the ACE policy included a professional services exclusion ("PSE") which provided that the policy did not respond to liabilities arising from "the rendering of or failure to render professional services". ACE submits that the PSE operated to exclude its liability to indemnify the JV, because the liability of the JV arose due to the JV's deficient design, design being a "professional service".

Lloyds, on the other hand, asserted that the PSE did not respond to the claims by the third parties, because the PSE only operated to exclude liability to clients with whom the JV had a professional relationship (ie: PowerGrid). His Honour upheld this view with reference to various case law.

It follows that his Honour held that the only liability to be potentially excluded by the PSE was the liability of the JV to PowerGrid, to whom the JV was rendering a professional service. However, since it was also held that GC14 had the effect of overriding the PSE by its operation, no liability was excluded by the PSE.

1. At [129]

HELD: “Professional services” exclusions only operate to exclude liability arising from professional relationships. This finding is also curious, given the authority of cases such as *Toomey –v– Scolaro’s Concrete Constructions Pty Ltd (in liq) (no 5)*² and others that it is the nature of the “particular activity” being undertaken by the insured, and not the relationship between the insured and the claimant, which is relevant.

5. The rule in Wayne Tank

The “Wayne Tank” principle (derived from *Wayne Tank & Pump Company Limited –v– Employers Liability Insurance Corporation Limited [1974]*) states that where a loss or damage arises by reason of 2 or more causes, one of which was excluded under the policy, then the policy did not respond.

Although this question did not arise due to his Honour’s finding that the operation of GC 14 excluded the PSE, it was considered whether this principle would operate to exclude any liability of the JV where the cause was the result of both professional and non-professional services.

His Honour concluded that the Wayne Tank principle would lead to the exclusion of liability for any damage arising in part from an excluded cause.

HELD: If an excluded event had some part to play in the liability imposed, the whole item of the claim would be excluded.

6. How many “occurrences” were there?

The expert retained by ACE, Dr Pells, geotechnical engineer, asserted that the above 4 problems represented only one “occurrence”, thereby limiting liability under the policies, which was “per occurrence”. The one occurrence was asserted by ACE as being the general failure by the JV to investigate and provide for prevailing groundwater and soil conditions.

His Honour rejected ACE’s contention that the general failure of the JV to deal with the ground and water conditions

could be properly described as “the event”. Rather his Honour found that the damage could be readily attributed to the various problems arising from different causes, and therefore being different events or occurrences.

HELD: For a series of facts to be described as an event there must be unity of time, location and cause. However, this was a question of degree to be decided with reference to the circumstances of the loss, from the point of view of an informed observer in the position of the insured.

7. Was Lloyds liable to indemnify the JV?

The Lloyds policy contained a “difference in conditions” clause, which purported to operate when a particular risk was also covered by another, “underlying” policy. If the scope of the underlying (in this case, ACE) policy was more expansive than that of the “master” (Lloyds) policy, then the master policy indemnifies the insured to the extent of the underlying policy.

Lloyds wished to assert that a “reasonable precautions” exclusion in the Lloyds policy applied to limit the scope of the policy to an extent that the “underlying” (ACE) policy would provide better cover. If this was the case, then the terms and conditions of the ACE policy (which did not contain a “reasonable precautions” clause) would apply, in effect, to the Lloyds policy. ACE would then not be able to assert that Lloyds could have relied on that provision to preclude payment to the insured, and that Lloyds was therefore not liable under its policy in respect of the TBM/G4 damage, and therefore could not claim indemnity from ACE in respect of it.

His Honour found that the only basis upon which it could be asserted that the ACE policy provided more extensive cover than the Lloyds policy was if the Lloyds policy had an exclusion which applied, that was not contained in the ACE policy.

HELD: Although the Lloyds policy did have an exclusion that was not contained in the ACE policy (the “reasonable precautions” exclusion), it was not applied. Therefore, Lloyds could not rely on it to activate the difference in conditions clause, as the circumstances which triggered the clause would have precluded liability under the policy.

8. Construction of the “reasonable precautions” condition.

His Honour proceeded on the basis, in considering whether the “reasonable precautions” clause applied to the third parties (the PowerGrid claim was excluded by the PSE, as explained above), that such clauses are to be read in a restrictive way.

His Honour had reference to the case of *Fraser –v– BN Furman (Production) Limited [1967]* and other matters in finding that a reasonable precautions exclusion will not apply unless the insured recognises a danger and “deliberately courts” that danger by taking measures which he knows are inadequate to avert it. In the case of the TBM/G4 problem (being the only damage to which such an exclusion could apply) that if the insured only knew of the danger when it was encountered (ie: when the TBM encountered the G4 class rock), then this could not be seen as “deliberately courting” the risk, the risk being unknown until it arose.

His Honour found however that the insured was aware of the risk and, more importantly, had at its disposal the steps available to remove or reduce that risk (which it failed to take) and therefore that the JV breached the requirements for reasonable precautions under the Lloyds policy in relation to the damage caused by the TBM/G4 problem.

HELD: A “reasonable precautions” exclusion will not apply unless the insured recognises a danger and “deliberately courts” that danger by taking measures which he knows are inadequate to avert it, as the JV was found to have done in this case.

9. Dual insurance

His Honour concluded with reference to the above matters that both ACE and Lloyds were liable to indemnify the JV.

When 2 insurers cover the same risk, the whole of which indemnity was paid out by the first insurer for the benefit of both, then the first insurer has the right to claim pro rata contribution from the second insurer.

His Honour found, with reference to various case law, that ACE was "relieved of" the obligation to pay the insured by Lloyds' payment, and that it was therefore just and equitable for Lloyd's to be reimbursed.

His Honour confirmed that the two questions asked by Priestly JA in *Australian Eagle Insurance Company Limited –v– Mutual Acceptance (Insurance) Pty Limited [1983]* were the appropriate test, being:

- (a) Did the 2 insurers have a common burden?
- (b) If the insured were to be paid under both policies, would he be paid twice in respect of the same damage?

HELD: Once ACE had rejected the indemnity of the insured, his Honour found that the answer to each of these questions would be "yes", and therefore Lloyds could recoup moneys to the extent the other insurer (ACE) was "relieved" of liability.

Conclusion

Questions of quantum and apportionment are yet to be decided by the Court. Subject to their outcome, there may be room for appeal by both ACE and Lloyds.

If the matter is appealed, it will be interesting to see whether His Honour's approach to certain of the above issues is confirmed.

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