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MARITIME LAW ASSOCIATION OF AUSTRALIA & NEW ZEALAND ANNUAL CONFERENCE, FREMANTLE, NOVEMBER 2008

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1. INTRODUCTION

Construction All Risk and Erection All Risk (CAR/EAR) provides comprehensive coverage for the myriad risks energy and energy-related businesses face that are inherent in construction projects, from project inception through completion and beyond.

CAR Insurance covers all types of civil construction risks and includes works brought on site as part of contracts as well as temporary works erected or constructed on-site. EAR Insurance covers plant and machinery construction risks and can be extended to include third-party liability related to work conducted on contract sites.

Offshore CAR insurance is often offered on the WELCAR 2001 Offshore Construction Project Policy wording ("WELCAR"). WELCAR is the final incarnation of the construction wording developed and refined by the Wellington Syndicate in April 2001.

This paper provides an overview of the WELCAR policy and discusses, from a legal perspective, some of the issues which have arisen in practice in respect of its (and thereby similar worded CAR policies) interpretation and application.

2. OVERVIEW OF WELCAR 2001

As we will see, WELCAR is a very broad and continuous form of coverage. It incorporates all the stages of construction and installation into one continuous coverage and gives contractors' accessibility to the Policy thereby allowing the

principal operator and contractors to contract in an environment whereby each other's position is reasonably clear. The policy is separated into the following parts:

(i) Scope of Insurance (applicable to Sections I and II)

(ii) General Terms and Conditions (applicable to Sections I and II)

(iii) Section I – Physical Damage

(iv) Section II – Liability

(v) Declarations and Schedule A and B Limits

Subject to the policy terms, conditions and exclusions, the policy provides coverage for certain physical loss and damage and liabilities incurred by the assured. Section I – Physical Damage and Section II - Liability are distinct sections containing their own definitions and terms and conditions with each section being subject to the Scope of Insurance and General Terms and Conditions parts of the policy.

3. SCOPE OF INSURANCE

3.1 General

The policy provides cover for a wide range of activities undertaken in the course of a particular project. The covered activities expressly include "procurement, construction, fabrication, load out, loading/unloading, transportation by land, sea or air, storage, towage, mating, installation, burying, hook-up, connection and/or tie-in operations, testing and commissioning, existence, initial operations and maintenance, project studies, engineering, design, project management, testing, trials, pipe laying, trenching and commissioning[1].

The "direct consequences" of drilling operations are excluded from the Scope of Insurance unless such drilling operations have been declared to and agreed by underwriters[2].

[1] WELCAR 2001 – Scope of Insurance
[2] WELCAR 2001 – Scope of Insurance

3.2 Assureds

A distinction is made in the policy between "Principal Assureds" and "Other Assureds"[3].

It is common practice in large construction projects for the lead or "turnkey" contractor to take out insurance to cover the entire project. As a result, individual sub-contractors do not need to effect cover for their specific part of the works of the project.

The "Principal Assured" will be the operator and its co-venturers in the project[4] and sometimes an operating company specifically appointed by the consortium to fulfil the role of operator. The Principal Assured includes any related companies of the named Principal Assureds as well as their directors, officers and employees, while acting in their capacities as such[5].

"Other Assureds" are the project managers[6] and any other entity (including contractors and/or subcontractors and/or manufacturers and/or suppliers) with whom any assured named in the policy has entered into a written contract directly in connection with the Project[7].

As a result, a sub-contractor who is not himself named in the policy will be an assured as long as he has a written contract with an entity that is named in the policy.

3.3 Special Conditions for "Other Assureds"

If a subcontractor comes within the definition of Other Assureds under the policy, it is a condition precedent before any such subcontractor can benefit from the Other Assured status under the policy, that it has performed its operations according to a Quality Assurance/Quality Control system ("QA/QC") which complies with the QA/QC provisions passed on by the Principal Assured through the subcontracts[8]. In practice,

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[3] WELCAR 2001 – Scope of Insurance - Clause 1
[4] WELCAR 2001 – Scope of Insurance – Clause 1(i)
[5] WELCAR 2001– Scope of Insurance – Clause 1(ii)
[6] WELCAR 2001 – Scope of Insurance – Clause 1(iii)
[7] WELCAR 2001– Scope of Insurance – Clause 1(iv)
[8] WELCAR 2001 – Scope of Insurance – Clause 2

this requirement is sometimes deleted allowing much wider protection for subcontractors.

The benefit of the insurance to Other Assureds is only exercisable through the Principal Assureds such that a subcontractor does not have the liberty to sue Underwriters directly[9].

3.4 Policy Period

3.4.1 Project Period (Sections I and II)

The policy attaches from such date which is agreed which is usually at some time prior to the commencement of procurement of materials for the project and continues usually until an agreed termination date. The policy attaches and insures in respect of each part, item or portion of the property insured which is at risk of an assured at inception or which becomes at risk after inception and thereafter remains continuously covered until completion of the last part, item or portion of the property insured[10].

3.4.2 Maintenance Period (Section I only)

Whilst the agreed termination date is the cut off point for claims relating to construction work there is ongoing coverage in relation to the obligations contractors have made to the operator by way of maintenance. Underwriters provide maintenance cover in respect of physical damage for the maintenance period which runs from the completion of the project period up to a period of twelve months[11].

The Maintenance Clause itself (contained in Section I – Physical Damage part of the policy) provides that the additional cover is no wider than that contained elsewhere in the policy. In effect, the Maintenance Period extends the insured period in respect of physical loss or damage to the works arising from faulty designs, workmanship or materials[12].

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[9] WELCAR 2001– Scope of Insurance – Clause 2
[10] WELCAR 2001– Scope of Insurance – Clause 4 & Clause 3 of Declarations
[11] WELCAR 2001 – Scope of Insurance – Clause 4 & Clause 3 of Declarations
[12] WELCAR 2001 – Section I – Terms & Conditions - Clause 19

3.4.3 Discovery Period (Sections I and II)

The Discovery Period commences on the same date and runs concurrently with the twelve months Maintenance Period[13]. Pursuant to the discovery clause (contained in the General Terms & Conditions part of the policy), claims under the policy shall only be recoverable if the Assured has discovered and reported such loss, damage or Occurrence (as defined) to underwriters within twelve months from expiry of the Project Period[14].

4. GENERAL TERMS AND CONDITIONS (Sections I & II)

The General Terms and Conditions are applicable to Sections I and II of the policy.

4.1 Subrogation and Waiver of Subrogation

Underwriters are subrogated to all rights which the Assured may have against any person or entity other than Principal Assureds and Other Assureds, in respect of any claim or payment made under the policy[15].

Since there are potentially many parties insured under the policy by virtue of the assureds clause providing benefits of the policy to, for instance subcontractors, it is important that the policy provides a comprehensive waiver of insurer's rights of subrogation. Accordingly, the policy provides that Underwriters waive their rights of subrogation against any Principal Assureds and/or Other Assureds[16].

There is an important caveat in respect of the waiver of subrogation against Other Assureds. Along the same lines as the condition precedent applied to Other Assureds before they can obtain the benefit of the policy[17], it is a condition precedent before Other Assureds can benefit from Underwriter's waiver of subrogation that they, the Other Assureds, performed their operations according to the QA/QC systems passed on to them by the Principal Assureds through the written contracts awarded to them in the project[18]. But again, this requirement is sometimes deleted giving wider protection to subcontractors.

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[13] WELCAR 2001 – Scope of Insurance – Clause 4 & Item 3 of Declarations
[14] WELCAR 2001 – General Terms & Conditions – Clause 20
[15] WELCAR 2001 – General Terms & Conditions – Clause 2
[16] WELCAR 2001 – General Terms & Conditions – Clause 3
[17] WELCAR 2001– Scope of Insurance – Clause 2
[18] WELCAR 2001 – General Terms & Conditions – Clause 3

Otherwise, the waiver of subrogation provision in WELCAR is unqualified. It provides that *"Underwriters agree to waive rights of subrogation against any Principal assured(s) and/or Other Assured(s)."* It is not qualified by words such as "whose interests are covered by this policy" for instance. In *National Oilwell Ltd v Davy Offshore Ltd*[19] the Claimants entered into an agreement for the supply to the defendants of a sub sea wellhead completion system to be used as part of a floating oil production facility, which Davy Offshore Ltd (DOL) were constructing for use on the Emerald Field in the North Sea. The Claimant claimed for payment and the Defendant counterclaimed for defective parts. The insurers of the Defendant paid out under the Builders All Risk policy taken out by the Defendant on its own behalf and that of the Claimant. The insurers then stepped into the shoes of the Defendant and took up the counter claim against the Claimant.

The relevant waiver clause stated:

"*Underwriters agree to waive rights of subrogation against any Assured and any person, company or corporation whose interests are covered by this policy and against any employee, agent or contractor of the Principal Assureds or any individual, agent, firm affiliate or corporation for whom the Principal Assureds may be acting*".

By use of the words "against any assured and any person, company or corporation whose interests are covered by this policy" the waiver of subrogation clause was held to confine the effect of waiver to claims under the policy for losses which were insured for the benefit of the party claimed against. In other words, in that case, the Claimants did not qualify for the benefit of the waiver clause merely by being a party to the contract of insurance. The benefit was only available for insured losses.

Under WELCAR, if an Other Assured does not comply with the relevant QA/QC systems then he will have no primary cover under the Policy, nor will he have the protection of Underwriters waiver of subrogation[20].

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[19] [1993] 2 Lloyd's Rep 582, 591

[20] The express waiver of subrogation clause avoids the need to grapple with the question of whether it would be an implied term of the policy that one assured will not sue another assured in respect of loss or damage for which they are both insured: *Board of Trustees of the Tate Gallery v Duffy Construction Ltd & Anor* [2007] EWHC 361 (TCC). Cf *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls Royce Motor Cars Ltd* [2008] EWCA Civ 286

4.2 Law and Jurisdiction

The policy is governed by English law and practice and all disputes arising out of or relating to the policy are subject to the exclusive jurisdiction of the courts of England and Wales[21].

4.3 Due Diligence

It is a condition of the policy that the Assureds exercise due care and diligence in the conduct of all operations covered by the policy[22].

The onus of proving a breach of a term of an insurance policy which would relieve the insurer from liability in respect of a particular loss is, unless the policy otherwise provides, on the insurer[23]. Therefore, if Underwriters wish to seek to assert a breach of the Due Diligence condition as a defence to a claim, it will be for Underwriters to prove that the Assured was in breach of the Due Diligence obligation.

5. PHASED LIMITS (SCHEDULES A & B)

Before turning to consider the provisions of Sections I and II of the Policy, it is necessary to appreciate the scheme of Schedules A and B to the Policy.

The policy provides for there to be agreed phased limits over the construction programme. These phased limits relate to the main components, such as jacket, modules and deck. As the items are installed the limits escalate, always reflecting the likely maximum exposure at any location at any one time. These phased limits are agreed at the outset and listed within the policy as Schedule B[24]. Without phased limits, the full policy limit would be available for a repair or replacement of only a partial loss.

Schedule B is concerned with damage repairs but the policy provides additional limits for expenditures such as removal of wreck and sue and labour. These additional

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[21] WELCAR 2001 – General Terms & Conditions – Clause 6
[22] WELCAR 2001 – General Terms & Conditions – Clause 10
[23] *Bond Air Services Ltd v. Hill* [1955] 2 All ER 476; *Stebbing v. Liverpool and London and Globe Insurance Co Ltd* [1917] 2 KB 433
[24] WELCAR 2001 – Schedule B

limits are dealt with under schedule A which states the overall policy limits for each main component and the ultimate overall limit applicable to the policy[25].

6. SECTION 1 – PHYSICAL DAMAGE

6.1 Introduction

The perils covered under the physical damage section of the policy comprise the following categories of risk:

Loss or Damage

All risk of physical loss or damage arising from an Occurrence within the policy period[26].

Expenditures

(a) General average and salvage charges;[27]

(b) Sue and labour;[28]

(c) Additional work (repositioning etc);[29]

(d) Removal of wreckage or debris;[30]

(e) Miscellaneous other costs such as retesting, standby charges, survey/adjusting fees.[31]

6.2 All Risk of Physical Loss or Damage

In the insuring clause, only "physical" loss or damage is covered[32] and such a physical loss or damage must result from an Occurrence which means "one loss, accident, disaster or casualty or series of losses, accidents, disasters or casualties

[25] WELCAR 2001 – Schedule A
[26] WELCAR 2001 – Section I – Clause 1
[27] WELCAR 2001 – Section I – Terms & Conditions - Clause 8
[28] WELCAR 2001 – Section I – Terms & Conditions - Clause 9
[29] WELCAR 2001 – Section I – Terms & Conditions - Clause 10
[30] WELCAR 2001 – Section I – Terms & Conditions - Clause 11
[31] WELCAR 2001 – Section I – Terms & Conditions - Clause 12, 13 & 14
[32] WELCAR 2001 – Section I – Clause 1

arising out of one event"[33]. This is an "events based" definition as distinct from being "caused based". The definition of an "Occurrence" in the policy also incorporates an "hours clause" whereby losses arising from earthquakes, storms etc over a 72 hour period will be treated as having arisen from the one event. Later in this paper we discuss in further depth the meaning of "Occurrence" in Section I – Physical Damage of the policy.

Also later in this paper, we discuss the meaning of "physical loss or damage". In short, there needs to be some sort of physical change to the insured property.

The insuring clause insures against "risk" of physical loss or damage. The concept of "risk" and in that regard, fortuity is discussed later in this paper. But briefly, a risk can be said to be a fortuity or an accident, which is not inevitable. That is to say, there must be some element of chance or the failure on the part of the Assured to foresee an event which could not have been reasonably anticipated. An inevitable loss is one which is bound to arise and would therefore be foreseeable.

6.3 Expenditures

6.3.1 General average and salvage charges

In the context of offshore construction, a general average event is likely to arise during sea carriage of materials to fabrication sites or during offshore towages. Salvage concerns services provided by salvors in salvaging vessels in danger and towing them to ports of refuge. The policy pays the assureds general average contributions and salvage liabilities up to policy limits[34].

6.3.2 Sue and labour

"Sue and labour" concerns expenditures by the assured to avert or minimise a loss which would fall under Section I of the policy. Expenditure is recoverable, proportionate to the Assured and Underwriter's respective interests. Underwriters' liability is limited to 25% of the agreed Schedule B value at the time of loss of the item subject to sue and labour expenditure[35].

[33] WELCAR 2001 – Section I – Definitions -Clause 1
[34] WELCAR 2001 – Section I – Terms & Conditions - Clause 8
[35] WELCAR 2001 – Section I – Terms & Conditions - Clause 9

6.3.3 Additional work

If the structure insured property is set down or wrongly positioned as a result of a peril insured against, cover is provided for the cost of additional work that is required in respect of repositioning costs etc to the extent to which such costs do not fall within the cover afforded by the sue and labour clause. Underwriters' liability is limited to the amount recoverable under the sue and labour clause (that is, 25% of Schedule B value at the relevant time) and then only to the extent that the limit has not been exhausted by a claim under the sue and labour clause[36].

An express exclusion to the coverage under Section I is for any claim by reason of the platform or structure being placed in the wrong position unless caused by an Occurrence covered by Section I. The positioning of the structure is a delicate and precise operation with the costs of repositioning being potentially very large. In essence, there is no cover for a miscalculation being made on the positioning of the structure but there is cover if an insured fortuity (for example a collision) caused the structure to be positioned in the wrong position.

6.3.4 Removal of wreckage or debris

The cost to remove the wreck of insured property following an Occurrence covered by Section I of the policy is recoverable provided that the incurring of such costs was either compulsory, the assured had a written contractual obligation to remove the wreck or if the wreckage or debris interferes with the assureds normal operations. Underwriters' liability is capped at 25% of the Schedule B value at the time of the loss of the items which are the subject of removal[37].

6.3.5 Miscellaneous

Cover is also provided for the repeat of testing and trial tests as a result of a physical loss or damage covered under Section I of the policy[38]. Cover is also provided for the cost of standby time on vessels engaged in the course of repair following an Occurrence covered under Section 1 provided that the assured is prevented from working in, around or about the damaged property by bad weather[39].

In the event of loss or damage covered under Section I, the Assured can in the case of emergency or over weekends instruct loss adjusters, the cost of which is covered

[36] WELCAR 2001 – Section I – Terms & Conditions - Clause 10
[37] WELCAR 2001 – Section I – Terms & Conditions - Clause 11
[38] WELCAR 2001 – Section I – Terms & Conditions - Clause 12
[39] WELCAR 2001 – Section I – Terms & Conditions - Clause 13

by Underwriters. In other circumstances, loss adjusters are appointed by Underwriters following loss notification by the Assured[40].

6.4 Other Terms and Conditions (Section I only)

6.4.1 Basis of Recovery

6.4.1.1 Repaired Damage

Underwriters agree to indemnify the Assured on a "new for old" basis. Costs are reimbursed at the point of loss such that towage, installation and all other costs necessarily incurred in the repair or replacement are also covered[41].

6.4.1.2 Redesign/New Design

It is often desirable to repair or replace a lost or damaged item with a superior item benefiting from state-of-the-art design and construction. If so, then the Policy provides for an allowance must be made for any increased cost that is incurred to reflect the cost of repairing or replacing with a similar part to the original item which was lost or damaged.[42]

6.4.1.3 Unrepaired Damage

For items which are a total or constructive total loss the actual item costs incurred up to the time of loss as per the latest agreed Schedule B values are recoverable. For partial loss or damage the reasonable depreciation arising from the unrepaired damage is recoverable[43].

6.5 Incorporated Clauses

WELCAR incorporates a number of printed Institute clauses the most important of which are the Institute Clauses for Builders Risk (1st June 1988), Institute Cargo Clauses (A) (1st January 1982), Institute War Clauses (1st January 1982) including

[40] WELCAR 2001 – Section I – Terms & Conditions - Clause 14
[41] WELCAR 2001 – Section I – Terms & Conditions - Clause 1(a)
[42] WELCAR 2001 – Section I – Terms & Conditions - Clause 1(b)
[43] WELCAR 2001 – Section I – Terms & Conditions - Clause 1(c)

(Air) and (Post) and the Institute Strikes, Riots and civil Commotions Clauses (1st January 1982),

6.6 Loss Notification

The Assured is obligated to render a signed and sworn proof of loss as soon as reasonably practicable after an occurrence stating the time, place and cause of loss, the interest of the Assured and of all others in the property, the value thereof and the amount of loss or damage thereto[44].

Later in this paper we discuss in further depth the loss notification requirements of both Sections I and II to the policy and the consequences of a failure to notify as required by the policy.

6.7 Defective Parts

"A defective part" is defined as meaning any part of the subject matter insured which becomes defective and/or unfit or unsuitable for its actual intended purpose, whether by reason of faulty design, faulty materials, faulty workmanship, a combination of those or for any other reason whatsoever[45]. Further "defective part" includes any ancillary components which are not themselves faulty but which would normally be removed and replaced by new components when the component that is faulty is rectified[46].

The cover afforded by Section I of the policy covers physical loss or damage to insured property resulting from a defective part, a faulty design, faulty materials, faulty or defective workmanship or latent defect even though the fault in design may have occurred prior to the attachments and date of the policy. However, the policy does not provide coverage for loss or damage to the defective part itself unless the defective part suffered physical loss or damage during the Policy Period caused by an insured peril external to that part and the defect (in the part) did not cause or contribute to the physical loss or damage to the part itself[47].

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[44] WELCAR 2001 – Section I – Terms & Conditions - Clause 3
[45] WELCAR 2001 – Section I – Terms & Conditions - Clause 7
[46] WELCAR 2001 – Section I – Terms & Conditions - Clause 7
[47] WELCAR 2001 – Section I – Terms & Conditions - Clause 7

However, by payment of an additional premium, the assured can take out defective part buy back whereby cover is provided for the cost of repair or replacement of defective parts subject to a deductible for each part and a total aggregate limit for the period of the policy.[48]

6.8 Exclusions (Section I only)

There are a number of exclusions to the coverage afforded by Section I – Liability. Excluded from coverage are:

(a) vessels, except for floating materials that are destined to become a permanent part of the Project and are declared and accepted by Underwriters prior to loss[49];

(b) aircraft and/or helicopters[50];

(c) temporary works, property, equipment etc not owned by the Principal Assureds and are not for incorporation in the contract work, unless agreed by Underwriters prior to loss[51];

(d) penalties for non-completion or delay or non-compliance with contract conditions[52];

(e) any claim by reason of the platform or structure being placed in the wrong location unless caused by an occurrence covered by Section I of the policy[53];

(f) loss of use or delay in start-up[54];

(g) liability assumed under Performance Guarantees given by suppliers[55];

(h) infidelity of a Principal Assured[56];

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[48] WELCAR 2001 – Endorsement 1
[49] WELCAR 2001 – Section I – Exclusions - Clause 1(a)
[50] WELCAR 2001 – Section I – Exclusions - Clause 1(b)
[51] WELCAR 2001 – Section I – Exclusions - Clause 1(c)
[52] WELCAR 2001 – Section I – Exclusions - Clause 1(d)
[53] WELCAR 2001 – Section I – Exclusions - Clause 1(e)
[54] WELCAR 2001 – Section I – Exclusions - Clause 1(f)
[55] WELCAR 2001 – Section I – Exclusions - Clause 1(g)

(i) wear and tear[57];

(j) any claim arising from the dumping of rocks and/or similar materials in the wrong position[58];

(k) all operations, assets or equipment etc for which related budgeted costs are not included within the latest agreed Schedule B[59];

(l) faulty welds[60];

(m) nuclear risks and radioactive contamination[61];

(n) war risks to properties on land or installed at the off-shore site[62];

(o) terrorist risks although this coverage may be reinstated pursuant to the Terrorist Buyback clause in the policy[63].

6.9 Policy Limits (Section I only)

Underwriters total liability under Section I for claims arising out of any one Occurrence shall not exceed 125% of the latest agreed Schedule B values, including payments made under the sue and labour clause, the additional work clause and the removal of wreckage/debris clause[64].

Since at the time the risk is bound the declared values are estimated and therefore provisional, it is agreed that the final completed value of the property insured shall be the insured value with pro rata adjustment being made in respect of premium. The mechanism by which this is achieved is the Escalation Clause which allows the provisional value to fluctuate but with an upper limit of 125% of the estimated completed value[65].

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[56] WELCAR 2001 – Section I – Exclusions - Clause 1(h)
[57] WELCAR 2001 – Section I – Exclusions - Clause 1(i)
[58] WELCAR 2001 – Section I – Exclusions - Clause 1(j)
[59] WELCAR 2001 – Section I – Exclusions - Clause 1(k)
[60] WELCAR 2001 – Section I – Exclusions - Clause 1(l)
[61] WELCAR 2001 – Section I – Exclusions - Clause 1(m)
[62] WELCAR 2001 – Section I – Exclusions - Clause 2(i) & (ii)(a)
[63] WELCAR 2001 – Section I – Exclusions - Clause 2(ii)(b)
[64] WELCAR 2001 – Section I – Clause 3
[65] WELCAR 2001 – Section I – Clause 5

6.10 Deductibles (Section I only)

Whilst there is usually one deductible in respect of claims under Section II - Liability there are a range of deductibles applicable to Section I – Physical Damage[66]. There are separate deductibles for:

(a) cargo sendings[67];
(b) on-shore fabrication risks[68];
(c) tows within waters to final off-shore site[69];
(d) off-shore works and associated subsequent maintenance[70];
(e) pipe laying[71];
(f) stand-by charges[72];
(g) all other non-specified occurrences[73].

Each of these deductibles apply in respect of "each and every Occurrence" and as observed above, "Occurrence" is defined to mean "one loss, accident, disaster or casualty or series of losses, accidents, disasters or casualties arising out of one event"[74]. The meaning of "Occurrence" in Section I – Physical Damage of the policy is discussed in further depth later in this paper.

The Operator will often make his contractors responsible for incurred deductibles and as such the deductibles need to be negotiated at levels commercially acceptable. As a result, deductibles tend to be on the lower side for land side activities and in the initial procurement stage but once the project reaches the off-shore stage the deductibles increase significantly. This reflects the fact that off-shore repair costs will require the use of specialised equipment at significantly higher costs to land side repairs. For the same reason, pipe laying deductibles will be substantial reflecting the high cost of sub-sea repairs.

[66] WELCAR 2001 – Section I – Clause 4 & Clause 5 of Declarations
[67] WELCAR 2001 – Clause 5(i) of Declarations
[68] WELCAR 2001 – Clause 5(ii) of Declarations
[69] WELCAR 2001 – Clause 5(iii) of Declarations
[70] WELCAR 2001 – Clause 5(iv) of Declarations
[71] WELCAR 2001 – Clause 5(v) of Declarations
[72] WELCAR 2001 – Clause 5(vi) of Declarations
[73] WELCAR 2001 – Clause 5(vii) of Declarations

7. SECTION II – LIABILITY

7.1 Coverage

Under the insuring agreement, Underwriters agree to indemnify the Assured in respect of liabilities imposed by law and/or by Express Contractual Liability[75] for:

(a) *Bodily Injury* – which is defined to mean bodily injury, sickness or disease, death, mental anguish accidentally sustained by any person by reason of the Assureds operations as declared under the policy[76].

(b) *Property Damage* – defined to mean physical loss or direct damage to or destruction of property, including the loss of use thereof. Liabilities in respect of the loss of use of property which itself has not been damaged is also covered provided that such loss of use is caused by an occurrence during the policy period. To be covered all property damage losses must be accidental and sustained by reason of the Assureds operations as declared to Underwriters[77].

The Bodily Injury or Property Damage must be caused by an Occurrence which takes place during the Project Period and arises out of the activities described in the Scope of Insurance section of the policy[78]. "Occurrence" is defined 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 Assured[79].

"Express Contractual Liability" means a liability that the Assured has expressly assumed prior to the relevant Occurrence, in any written contract or oral contract subsequently reduced to writing within seven days thereafter[80].

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[74] WELCAR 2001 – Section I – Definitions -Clause 1
[75] WELCAR 2001 – Section II – Clause 1
[76] WELCAR 2001 – Section II – Definitions – Clause 1
[77] WELCAR 2001 – Section II – Definitions – Clause 6
[78] WELCAR 2001 – Section II – Clause 1
[79] WELCAR 2001 – Section II – Definitions – Clause 5

7.2 Defence and Settlement

Underwriters are not obliged to assume the conduct of the defence of any claim or suit brought against the Assured but Underwriters do have the right to be given the opportunity to associate with the Assured in the defence and control of the claim and where the claim is reasonably likely to involve amounts payable by Underwriters, there is an obligation on the Assured and Underwriters to co-operate in the defence of such a claim[81].

7.3 Other Terms and Conditions (Section II only)

7.3.1 Notice to Underwriters

In the event of an Occurrence the Assured is obliged to provide written notice to Underwriters as soon as is practicable stating the specific Occurrence, the damages which may result or have resulted from the Occurrence and the circumstance by which the Assured first became aware of the Occurrence[82]. Whilst the notice needs to be in writing, it not be verified as is the case for loss notifications under the physical loss and damage section of the policy.[83]

7.3.2 Admission of Liability

The Assured is not to acknowledge or admit any liability in respect of an Occurrence or to settle or negotiate the settlement of the claim without the consent of Underwriters[84].

7.3.3 Cross Liabilities

The "Cross Liabilities" clause under the Policy enables one Assured to sue another Assured under the Policy by treating the parties as if separately insured by different policies[85]. However this does not operate to increase the limit of liability under Section II.

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[80] WELCAR 2001 – Section II – Definitions – Clause 4
[81] WELCAR 2001 – Section II – Clause 4
[82] WELCAR 2001 – Section II – Terms & Conditions – Clause 1
[83] WELCAR 2001 – Section I – Terms & Conditions - Clause 3
[84] WELCAR 2001 – Section II – Terms & Conditions – Clause 2
[85] WELCAR 2001 – Section II – Terms & Conditions – Clause 4

Depending upon relevant exclusions and the applicable deductibles it might some times be beneficial for an Assured to seek recovery under Section II as opposed to under Section I. To avoid this, there is an exclusion that no recovery can be made under the Cross Liabilities clause for physical loss or damage insured under Section I[86].

Finally, coverage in respect of Other Assureds liability to contractors, vendors or suppliers etc does not include liability for consequential losses, loss of profit or business interruption[87].

7.4 Exclusions (Section II only)

There are quite a number of exclusions to the coverage afforded by Section II. Excluded from coverage are:

(a) liabilities arising out of operations in intentional violation of laws[88];

(b) motor vehicles, trains or aircraft although the exclusion does not apply to crawler type tractors, diggers, graders etc which are not subject to motor vehicle registration[89];

(c) war and terrorist risks[90];

(d) damage to or loss of tools, materials or equipment whilst performing operations for an Assured[91];

(e) arising out of the use or operation of vessels unless declared to Underwriters[92];

(f) workers compensation and employers' liabilities[93];

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[86] WELCAR 2001 – Section II – Terms & Conditions – Clause 4
[87] WELCAR 2001 – Section II – Terms & Conditions – Clause 4
[88] WELCAR 2001 – Section II – Exclusions – Clause 1
[89] WELCAR 2001 – Section II – Exclusions – Clause 2
[90] WELCAR 2001 – Section II – Exclusions – Clause 3
[91] WELCAR 2001 – Section II – Exclusions – Clause 4
[92] WELCAR 2001 – Section II – Exclusions – Clause 5
[93] WELCAR 2001 – Section II – Exclusions – Clauses 6-10

(g) for loss of or damage to any well or hole being drilled or worked over by the Assured or in the Assureds care and custody[94];

(h) for any costs or expenses incurred in re-drilling or restoring any well or hole[95];

(i) for loss of or damage to any drilling equipment below the surface in any well or hole being drilled or worked on by the Assured or in the Assureds care and custody[96];

(j) control of well[97];

(k) Bodily Injury or Property Damage directly or indirectly caused by seepage, pollution or contamination, subject to certain exceptions[98];

(l) treatment and disposal of waste materials[99];

(m) subsidence caused by sub-surface operations of the Assured[100];

(n) loss of or damage to sub-surface oil, gas, water or other substances[101];

(o) fines, penalties, punitive or exemplary damages[102];

(p) manufacture, sale and distribution of goods or products[103];

(q) damage to or loss of or loss of use of property owned or occupied, used or in the care, custody or control of the Assured[104];

(r) provision of professional services such as the preparation or approval of maps, plans, opinions, reports, surveys, designs and specifications[105];

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[94] WELCAR 2001 – Section II – Exclusions – Clause 11
[95] WELCAR 2001 – Section II – Exclusions – Clause 12
[96] WELCAR 2001 – Section II – Exclusions – Clause 13
[97] WELCAR 2001 – Section II – Exclusions – Clause 14
[98] WELCAR 2001 – Section II – Exclusions – Clause 15
[99] WELCAR 2001 – Section II – Exclusions – Clause 16
[100] WELCAR 2001 – Section II – Exclusions – Clause 17
[101] WELCAR 2001 – Section II – Exclusions – Clause 18
[102] WELCAR 2001 – Section II – Exclusions – Clause 19
[103] WELCAR 2001 – Section II – Exclusions – Clause 20
[104] WELCAR 2001 – Section II – Exclusions – Clause 21
[105] WELCAR 2001 – Section II – Exclusions – Clause 22

(s) dust diseases, chemical exposures[106];

(t) nuclear risks and radio-active contamination[107];

(u) assumed under a warranty for fitness or quality of the Assureds products or a warranty that work performed by or on behalf to the Assured should be done in a workmanlike manner[108].

7.5 Policy Limits (Section II only)

The Declarations to the policy provide for a limit of Underwriters liability under Section II for all "Ultimate Net Loss" by reason of any one Occurrence[109]. "Ultimate Net Loss" means the total sum the Assured is obligated to pay as Damages including Claim's Expenses in respect of claims covered under the policy[110]. "Damages" means compensatory damages, monetary judgments, awards and compromise settlements entered into with Underwriters consent. It expressly does not include fines or penalties, punitive or exemplary damages or equitable or injunctive relief[111]. "Claims Expenses" means the reasonable legal costs and other expenses incurred by or on behalf of the Assured in the defence of any covered claim such as legal, investigative and adjustors' fees. It does not include salaries and wages of the Assureds employees nor does it include the Assureds administrative expenses[112].

7.6 Deductibles (Section II only)

There is usually one deductible in respect of claims under Section II – Liability per "any one Occurrence"[113].

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[106] WELCAR 2001 – Section II – Exclusions – Clause 23
[107] WELCAR 2001 – Section II – Exclusions – Clause 24
[108] WELCAR 2001 – Section II – Exclusions – Clause 25
[109] WELCAR 2001 – Section II - Clause 3
[110] WELCAR 2001 – Section II - Definitions – Clause 7
[111] WELCAR 2001 – Section II - Definitions – Clause 3
[112] WELCAR 2001 – Section II - Definitions – Clause 2
[113] WELCAR 2001 – Section II - Clause 2 & Clause 5 of Declarations

8. SOME PARTICULAR ISSUES

8.1 The Wear & Tear, Corrosion (Rust & Oxidisation) Exclusion

An exclusion to cover provided by Section I – Physical Damage is "wear and tear"[114]. The definition of wear and tear in Arnould, Law of Marine Insurance[115] has been judicially approved in *Midland Mainline Ltd v Commercial Union Assurance Co Ltd*[116]*:*

"Loss or damage under a hull policy is to be attributed to ordinary wear and tear... when it ... is merely the result of ordinary service conditions operating upon the hull or machinery, as for example when the relevant part wears out having reached the end of its expected working life, or when initially sound materials have undergone some process of deterioration, such as corrosion which was introduced in the ordinary course of trading and remains uncorrected."

In *Burts & Harvey Limited v Vulcan Boiler and General Insurance Co Ltd*[117], a business interruption policy contained an exclusion which provided *"excluding loss or damage resulting from wear and tear, corrosion, erosion, failure of any part or parts the nature or functions of which necessitate their regular replacement."* The policy also provided that the insurance did not cover loss resulting from "*wear and tear, deterioration or gradually developing flaws or defects*". This case is important because it shows a distinction which the English courts recognise between the excluded peril causing the loss or damage, when it operates, and situations where matters within the insured peril only arise as a consequence of an insured peril, when it is inoperative to debar recovery.

The insured operated a chemical plant for the production of maleic anhydride that was insured with the defendant insurers in respect of business interruption breakdown insurance. It was a new plant and production had commenced on 19 May 1961, but after 9 hours it broke down. The cause was outside the insurance cover on that occasion. Production was started again on 27 May but, on 4 June 1961, the plant had to be shut down again due to the build up of high pressures within it. Production re-commenced on 6 August and the insured claimed for its losses on the basis that the high pressures were caused by a crack in a tube in the

[114] WELCAR 2001 – Section I – Exclusions - Clause 1(i)
[115] (16th Edition, paragraph 780)
[116] (2004) 1 Lloyd's Rep 22 page 43
[117] [1966] 1 Lloyds Rep 161

heat exchanger. This crack had allowed water to mix with gaseous maleic anhydride and to form very corrosive maleic acid which then caused the damage. The insurers denied liability contending, *inter alia*, that the loss was due to the excluded causes of corrosion and/or was occasioned by the excluded peril of a gradually developing flaw or defect.

The expert evidence produced to the court was in agreement that during the construction of the honeycombed heat exchanger, which consisted of 280 mild steel tubes surrendered by a water jacket, the expansion process by which a water tight joint was created at each end of these tubes the steel end plate, (called drifting), had gone wrong. Splits had developed near the bottom plate of the honeycomb, whereby steam had escaped into the gaseous maleic anhydride. Later, water escaped through those splits and produced, in the end, maleic acid. The acid had the disastrous eroding effect of washing away the steel of a dozen tubes at the bottom end of the heat exchanger.

Mr Justice Lawton determined that the steam had begun to escape about 4 hours before the rising pressure was first noticed on 4 June, a further 4 hours passing before the part had been shut down. There could not have been any splits outside the end plates before then, otherwise trouble would have been encountered beforehand. The Judge held that the dominant or proximate cause of the accident was the splitting of one or more tubes in the heat exchanger, that event leading to the formation of the maleic acid and then the corrosion and erosion of the tubes of the heat exchanger. The insurers' defences therefore failed, because the corrosion was a consequence of sudden and accidental damage by a fortuitous cause which event was the operative insured peril. Construing the corrosion exclusion as it applied to the facts of that case, Lawton J held that it related only to the effects of gaseous maleic anhydride upon the tubes through which it would pass in the ordinary course of production, and did not operate to exclude corrosion or erosion which was consequential upon any breakdown of the plant due the failure of a component. He used the following language:

"It seems to me clear that what the Defendants had in mind was the effect of gaseous maleic anhydride upon the tubes through which it would pass in the ordinary process of production, and they had not in mind any corrosion or erosion which was consequential upon any breakdown of the plant due to the failure of a component".

The *Midland Mainline Ltd v Eagle Star Insurance Co Ltd*[118] case is of importance in a number of respects because it shows the approach of the English court to the modern application of a wear and tear exclusion and also issues of proximate cause and the application of deductibles. The litigation arose out of the Hatfield rail disaster of 17 October 2000 which was caused by a broken rail which in turn was caused by gauge corner cracking (GCC), a type of rolling contact fatigue (RCF). Immediately after the derailment, Railtrack, the owner and operator of the UK mainline railway network, imposed a number of emergency speed restrictions (ESRs) on parts of the network where GCCs were known to exist. This caused severe disruption to the timetables of train operating companies.

The train operating companies had a "denial of access" extension in their insurances under which cover was granted in the event of the assured being prevented from or hindered in the use of any part of the rail network. The policies contained a wear and tear exclusion which exclude liability for loss arising from:-

"*inherent vice, latent defect, gradual deterioration, wear and tear, frost, change in water table level, its own faulty or defective design or materials.*"

At first instances, Mr Justice David Steel concluded that he had no doubt that RCF was a paradigm example of wear and tear. The existence of RCF on a particular piece of track was influenced by a number of different characteristics including the type of railway vehicles running over the track, the operating conditions including the speed of trains and other environmental conditions.

Although the Judge at first instance concluded that, as a matter of fact, the damage to the rails was attributable to wear and tear, he also held that the proximate cause of the loss was not that wear and tear but rather was the imposition of the emergency speed restrictions and that the wear and tear was no more than the underlying state of affairs which provided the occasion for the imposition of those restrictions. Accordingly, on that basis, the exclusion did not preclude a claim.

The Court of Appeal took a different view holding that the Judge was wrong to seek to identify a single proximate cause and that it was well established by authority[119] that there could be one or more proximate causes. Although the Court of Appeal

[118] [2004] 1 Lloyd's Rep 739

would have reversed the trial judge and held that wear and tear was the proximate cause of the loss and therefore excluded, it did not matter because even if wear and tear and the emergency speed restrictions were both proximate causes it is well established as a matter of English law that the exclusion bites when there are two proximate causes, one of which is a covered loss and one which is excluded: *Wayne Tank & Pump Co Ltd v Employers Liability Assurance Corporation Ltd*[120],[121]

Sometimes, corrosion clauses draw a distinction between normal/expected corrosion, which should have been allowed for during the design process, and abnormal/unexpected corrosion, which was due to an intervening cause, eg. sheath perforation. This was the result in the *Burts & Harvey* case discussed above.

The authorities are very few and far between. There are virtually no English cases, but there is some guidance which is of persuasive value from the US Courts. In *Bettigole v American Employers Insurance Co*[122], an all risk policy contained exclusion against loss caused by corrosion. Structural damage to a parking deck was caused when chloride ions were brought on to the deck by de-icing salts on automobiles. The chloride ions gradually filtered through the concrete and attacked steel reinforcing bars. The damage was caused by corrosion and it was held by the US Court that the exclusion was not limited to wearing away by natural means but included corrosion resulting from the conduct of the insured and also corrosion created by the action of third parties.

In another American case, which adopted a different approach, it became important to look at the proximate cause of the loss. In *Adams –Arapahoe Joint School District v* Continental *Insurance Co* [1989] an all risk policy covered a school district against "*all risks and direct physical loss*" but excluded loss caused by rust or corrosion and inherent or latent defects unless such loss resulted from a peril not excluded in the policy. A portion of the roof collapsed due to corrosion that resulted from defective design or construction. The defective design and construction was not known at the

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[119] See *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918 AC 350] and "*The Miss Jay*" [1987] 1 Lloyds Rep 31

[120] [1974] 1QB 57

[121] For an interesting discussion of the *Wayne Tank* principle in an Australian context, see *McCarthy v. St Paul International Insurance Co Ltd* [2007] FCAFC 28 (14 March 2007) where the Full Federal Court saw the question as not being one of the application of any special *Wayne Tank* principle but rather as being a question of construction of the policy. Justice Allsop, with whom Justice Stone agreed, said: *"Once one concludes that, as a matter of construction of the contract, the insurer and insured have agreed that the cover does not extend to any loss caused by a particular cause, and that the loss was caused by that cause, the policy's lack of response can be seen as evident. It is only if one concludes that the parties have agreed that the policy will not respond if the excluded clause must be the sole cause, for the existence of a concurrent and not excluded cause to be relevant. Again this is a question of construction of the policy."*

time the policy was issued and was held not to be an inherent or latent defect but a fortuitous loss and was a covered risk. Therefore, the proximate cause of the loss was held to be not the corrosion but the fact of the design fault in that the corrosion would never have occurred if the roof had not been designed effectively.[123]

Some of the cases that deal with "*deterioration*" exclusions may also provide some guidance. As with corrosion, the US authorities tend to suggest that the meaning of "deterioration" will not be limited to normal deterioration where the term is unqualified in the exclusion. In *Murray v State Farm Fire and Casualty Co* [1990], damage was sustained as a result of a copper water pipe leak. It was caused by electrolysis resulting from a pipe being exposed to a combination of moisture and acidic soil. It was argued that deterioration meant natural deterioration of the copper pipe which could ordinarily be expected to last more than 17 years. The chemical reaction dramatically speeded up the process of the deterioration, but it was still held by the court to be covered by the exclusion.

The US cases tend to suggest that an unqualified exclusion such as "*corrosion*" can be given a wide meaning and can include corrosion caused by design defect.

8.2 Physical Loss & Damage

The insuring clause in Section I – Physical Damage provides cover only for *"physical loss..and /or physical damage"*[124]. Under English law there is little precedent in property insurance coverage cases, as to what is meant by physical loss or damage. The Oxford Dictionary definition of "damage" is:-

"Harm or injury impairing the value or usefulness of something".

Professor Clarke in his leading textbook "The Law of Insurance Contracts"[125] takes the view that-

"Damage usually refers to the physical state of a thing that has changed for the worse,[126] *and does "not include injury or damage which will happen in the future". In*

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[122] [1991] 30 Mass App 272, 567 NE 2b 1259

[124] WELCAR 2001 – Section I – Clause 1
[125] May 2006 Para 16-2C
[126] *Promet Engineering (Singapore) Pte Ltd v. Sturge & Others* [1997] 2 Lloyd's Rep 146

"common parlance", it means "mischief done to property". "Damage need not be permanent to constitute 'damage', and defacement certainly qualifies as damage even if easier and less costly to rectify" than fire damage, but the precise definition depends on the context in which the word is used. For example, scallops, which are perfectly fit for immediate consumption but have been raised to a temperature which has shortened their shelf life, may be damaged scallops for the insured who does not want them for immediate consumption but for sale in a foreign market.[127] *The goods have become less valuable than they were before, however, for there to be damage in the sense of an insurance contract, it will be necessary to produce the report of a food laboratory that a physical change has occurred in the scallops."*

Essentially, the damage must be capable of measure. Professor Clarke further refers to a case involving the insurance of a Degas pastel which sustained submolecular damage by being close to a fire. The policy in *Quorum v. Schramm*[128] provided cover for *"direct physical loss or direct physical damage of whatsoever nature to property as described in the Schedule."* Underwriters maintained that there was no direct damage to the pastel in respect of a stigma attaching to the picture, but the assured argued that the sub-molecular damage shortened the life of the pastel and increased the risk of deterioration.

Mr Justice Thomas held:

"I do not agree with that (i.e. the underwriters' submission) on the facts of this case as I found them to be. I accept that depreciation in value because of the suspicion of possible physical damage is not covered. However, I have found that there was sub-molecular damage to the paste caused by the fire; that was, in my view, damage to the picture. In my view such damage is clearly direct physical damage resulting from the fire, even though it might not be visible and its extent could not be determined without testing which could not be carried out because of the effects on the pastel. That conclusion is supported by a decision of a Tasmanian Court in Ran/car *v. Fridge Mobile Pty. Ltd.,[1983] Tasmanian reports 113"*

There is some assistance from cases involving claims in tort or in criminal cases involving malicious damage. Although these cases are not directly relevant they may provide an indication of how an English court would approach the subject in a

[127] *Ranicar v. Frigmobile Pty Ltd* [1983] TAS R113 (Tasmania)
[128] [2002] 1 Lloyd's Rep 249

property insurance claim. What is clear from the authorities is that a decision will largely turn on the context in which the words are used.

In *Losinjska Plovidba v. Transco Overseas Limited (the "Orjula")*[129], Mr Justice Mance (as he then was) had to consider whether the contamination of the deck of a vessel by hydrochloric acid accidentally spilt amounted to damage to the vessel. The contamination was cleaned off and the only loss to the claimant was the financial cost of cleaning. Mance J in finding this was *"damage"* acknowledged there was little authority in a civil context as to the meaning of damage.

He reviewed certain criminal cases[130] involving prosecution for causing criminal damage. In *R v. Henderson and Batley* the issue before the court was the intentional or reckless damaging of a development land site. A site in the Isle of Dogs had been cleared for development but the defendants had purported to allow the use of the site as a public tip for reward. As a result, 30 lorry-loads of soil, rubble and mud were dumped on the site. The court rejected the defendants' argument that the site remained unaltered under this rubbish and therefore could not be said to have been damaged and referred to the case of *R v. Fisher*[131] where it was held that an obstruction which temporarily rendered a machine useless for the purpose for which it was intended to be used could be *"damage"*. This case involved a disgruntled employee, who had been employed to operate an agricultural steam engine, who upon his dismissal decided to put a piece of stick in the water feed. When charged with malicious damage, it was argued that no actual damage had been done. At first instance, it was held that there was damage because labour was required to reinstate the machine. On appeal, the court held:-

"We are all of the opinion that the conviction is good. It is like the case of spiking a gun, where there is no actual damage done to the gun, although it is rendered useless."

In the *"Orjula"*, Mance J thought that the guidance from the criminal courts was of some assistance. He concluded that relevant considerations were whether there has been *"injury impairing value and usefulness"* of the property in question, and the

[129] [1995] 2 Lloyd's Rep 395
[130] *R v. Henderson and Batley (1984) and Cox v. Riley (1986) Cr. App R. 54 and R v. Whitely (1991) 93 Cr. App. R. 25.*
[131] 1865 L.R. 1C.C.R.7

need for work and expenditure of money to restore the property to its former useable condition.

Mance J also went on to consider a decision at first instance at *Hunter v. London Docklands Development Corporation (1994).* In that case, the trial judge also regarded the old criminal cases as affording relevant guidance and applied them in a case involving claims in negligence and nuisance for the deposition of allegedly excessive quantities of dust on the plaintiffs' properties. He found on the facts that there had been damage. The *Hunter* case eventually went on appeal to the Court of Appeal[132] and then to the House of Lords[133]. It was held that the deposit of dust was, in principle, capable of giving rise to an action in negligence but whether it did, depended upon proof of physical damage and that depended on the evidence and the circumstances. Dust was an inevitable incidence of urban life and the claim arose on the assumption the respondents had caused *"excessive"* deposits. Reasonable conduct and a reasonable amount of cleaning to limit the ill effects of dust could be expected of householders. Subject to that, it was held that if, in ordinary use, the excessive deposit was trodden into the fabric of a carpet in such a way as to lessen the carpet's value or cause damage to electrical apparatus for example, an action would lie for the damage in the physical change which rendered the article less useful or less valuable. The Court of Appeal (approved by the House of Lords) held the meaning attributable to the word *"damage"* in a criminal statute might be different from that in the law of negligence. Pill L J who gave the leading judgment held:-

"The damage is in the physical change which renders the article less useful or valuable.....The fact it costs money or labour to remove a deposited material on property does not necessarily involve a finding that the property has been damaged".

Pill LJ also referred to a decision of Bingham LJ in *Simaan General Contracting Co v. Pilkington Glass Limited (No. 2)*[134]. In that case, glazed units which, when supplied, were defective by reason of discrepancies in their colouring, were not physically damaged in the sense required in the law of negligence. In the absence of physical damage, it was held a mere deposit is not actionable.

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[132] (1996) 2 WLR 348
[133] (1997) 2 WLR 684
[134] [1998] QB 758

In *The Nukila*[135], the defendant underwriters provided insurance cover for the plaintiffs' accommodation platform Nukila in the terms of the Institute Time Clauses including the Inchmaree clause and the Institute Additional Perils Clause. The material clauses provided inter alia:

The Inchmaree clause:

This insurance covers damage to the subject matter insured caused by: . . .

6.2.2

bursting of boilers breakage of shafts or any latent defect in the machinery or hull . . .

The Institute Additional Perils Clause - Hulls:

In consideration of an additional premium this insurance is extended to cover

The cost of repairing or replacing

any boiler which bursts or shaft which breaks

any defective part which has caused loss or damage to the vessel covered by Clause 6.2.2 of the Institute Time Clauses . . .

Except as provided in 1.1.1 and 1.1.2 nothing in these Additional Perils Clauses shall allow any claim for the cost of repairing or replacing any part found to be defective as a result of a fault or error in design or construction and which has not caused loss of or damage to the vessel.

The platform when in position stood on three legs. These legs could be jacked up and down and when the legs were down the platform itself was jacked up above the surface of the sea. The steel legs were tubular 8ft. in diameter and 208ft. long and the foot of the tubular column passed through a 28ft. square 4ft. deep steel box called a spud can. The spud cans enabled the platform to sit squarely and firmly on the seabed. The spud can was designed to be watertight and its structure was

[135] *Promet Engineering (Singapore) Pte Ltd v. Sturge & Others* [1997] 2 Lloyd's Rep 146

strengthened by internal diaphragms and bulk-heads. It was fixed to the column by circumferential welds above and below its top and bottom plate and by welds at the points where the diaphragms and bulk-heads meet the column.

Fatigue cracking was caused by fatigue stress as a result of fluctuating loads set up by the normal action of the waves.

The platform was located in the Ardjuna Field in the Java sea in September, 1983. Its legs were inspected periodically but nothing untoward was discovered until February, 1987 when all three legs were found to be cracked at the joint between the column and the spud can. The platform was towed to Singapore where the cracks were examined in detail by Veritec on behalf of the assured.

Fatigue cracks had developed in the circumferential weld below the top plate which then extended through the thickness of the column and around its circumference and then into the top plate of the spud can and its internal diaphragms and bulkheads close to the weld. Such extensive cracking obviously meant that the platform was in danger of collapse at the time when it was discovered.

In due course the legs were repaired. The cost of the repairs were agreed at S.$903,148. The plaintiffs claimed this and other expenses under the insurance policy.

The defendants denied liability contending that there had not been any damage to the vessel as was required by the Inchmaree clause; if there was a latent defect in the hull or there was a defective part this had not caused consequential damage to the vessel of the kind covered by the policy.

The issues for decision were whether the vessel sustained damage and if so whether that damage was caused by an insured peril. The Court of Appeal (Sir Stephen Brown, P., Hobhouse and Ward, L.JJ.), held:

(1) the application of the language of the Inchmaree clause to the facts was straightforward; at the commencement of the period of cover there was a latent defect in the welds joining the underside of the top plate of each spud can to the external surface of the leg tube; by that time that latent defect had also given rise to minute fatigue cracks in the surface of the tube in the way of the weld which could

also be described as latent defects; those features caused extensive fractures in the full thickness of the tube extending in places both above and below the defective weld, extensive fractures in the metal of the top plating and bulkheads of the spud cans and other fractures at other locations; this was on any ordinary use of language damage to the subject-matter insured i.e. the hull and machinery of Nukila; it was caused by the condition of Nukila at the commencement of the period i.e. by the latent defect;

(2) on any ordinary use of language the legs and spud cans were damaged; they were damaged by being subject to stresses which they were unable to resist due to the latent defects i.e. the wrongly profiled welds and the incipient fatigue cracks;

(3) the use of the word "part" in cl. 1.1.2 of the Institute Additional Perils Clause provided no criterion for distinguishing between what was and what was not damage; the word part was capable of being used in a whole variety of ways depending on the context; the weld was a part just as much as was a bracket or bulkhead or plate or the totality of the leg structure; the use of the word "part" in the additional perils clause was normally simply to avoid the need to exclude from the indemnity to which the plaintiff was entitled if he proved a claim under the Inchmaree clause of deducting the cost of repairing or replacing the original defective part; it provided no guidance to the construction to be placed on the Inchmaree clause beyond emphasizing the need under the clause to prove that damage to the subject-matter insured was caused;

(4) the questions to be asked were: whether there was damage to the subject matter insured; whether the damage occurred during the period covered by the policy; and whether that was damage caused by a latent defect in the machinery or hull of the vessel; the answer to each of those questions was in the affirmative and the owners were entitled to recover an indemnity from the underwriters.

In *Jan de Nul (UK) Ltd. v. Axa Royale Beige SA*[136] the Court of Appeal considered, in the context of a liability policy, whether the acts of the insured dredging company who had caused silt and other material to float leading to blockage and contamination to berths on other parts of Southampton Water could be described as causing property damage. The claimants were users of the river bed and the court found that the deposit of silt on their berths amounted to property damage because it had

[136] [2002] 1 Lloyd's Rep 583

altered the land and it was accepted where silt was deposited on land the cost of removing it would be recoverable as the cost of making good damage to property. Accordingly, it was held that Jan de Nul were entitled to recover under their liability policy in respect of its liability to third parties for the cost of carrying out remedial works and that the policy exclusion in respect of claims for "pure" economic loss did not apply.

The more recent case of *Tioxide Europe Ltd v CGU International Insurance Pic & Ors*[137] concerned a claim for the discoloration of PVC windows and doors under liability policies. Pigments that were supplied for use in the manufacturer of the PVC products caused the discolouration to happen in certain environmental conditions. Although the court was primarily concerned with issues relating to notification provisions, Langley J followed previous case law when he stated that "an unwanted change of colour is in ordinary language a "physical" change and, if it impairs the value of the product, in my judgment it is physical injury".

There are also other dicta in insurance cases. In *Cementation Piling & Foundations Limited v. Aegon Insurance Co Limited and Commercial Union Insurance Co. Plc*[138], the court had to construe a policy providing an indemnity in respect of "physical loss of or damage to the property insured". The policy in question was a CAR policy covering the installation of some piled diaphragm walls forming part of a series of quays to be constructed within the docks at Barrow. An integral part of the scheme was the construction of a sand berm secured by a retaining wall. After completion, it was observed that quantities of sand retained by the wall had escaped into the newly constructed dock. This was because of gaps and voids between panels, which had permitted sand to escape. It was held that the cost of remedying the defects (i.e. the gaps) was part of the indemnity "in respect of physical damage in the property insured".

Mr Justice Pearson held in another case involving physical loss or damage in an insurance context, *Lewis Emmanuel & Son and Another v Hepburn*[139] that:

"*I should still hold that, in view of the subject matter being dealt with and the way in which those words are placed in this phrase, one would understand each of the three*

[137] [2004] EW HC 216 (Comm)
[138] [1993] 1 Lloyd's Rep 526
[139] [1960] 1 Lloyd's Rep 304

words, "loss", "damage" and "deterioration" as applying to physical happenings and not merely to financial happenings such as loss of market..."

Accordingly that just because costs are incurred in rectifying property it does not always follow that damage has occurred to that property.

In *James Longley & Co v Forest Giles Ltd*[140], the Court of Appeal had to consider the question of whether "damage" included the costs of rectifying defective work and included loss inflicted by reason of delay to handing over work. The Claimant was the main contractor employed to construct buildings for the University of Surrey and the defendant was a sub-contractor specialising in the laying of vinyl flooring who had taken out a public liability insurance policy. "Bubbling effects" had been observed by the claimant over the heavy-duty vinyl flooring laid by the defendant. Sections of the flooring were cut, revealing that the adhesive used by the defendant had not adequately cured because of excessive moisture contained within the Lytag screed. As a result of the bubbling effects substantial remedial works were required to be carried out by or on behalf of the claimant and the latter sought to recover from the defendant the cost of the remedial work and the damages which had arisen by reason of the "bubbling effect".

The Plaintiff relied on a section in Clarke on the Law of Insurance Contracts, 3rd edition, at para. 16-2A, which stated that the more common and wider meaning of "loss" is any loss, damage or deprivation suffered by the insured...which leaves him financially poorer than he was before. However, Potter LJ read on from that general observation in Clarke and relied on the following two sentences:

"That is the sense in the case of indemnity insurance on which the insured must prove a loss to found a claim. However, in the context of insurance covering "all risks by loss or damage to the subject matter insured", it has been confirmed that it applies only to physical loss or damage."

The Court of Appeal held that:

"It was not the usual intention, in a contractor's public liability insurance, to give cover in respect of defective workmanship which required rectification but did not cause

[140] [2002] 1 Lloyd's Rep 41

physical damage to the personal property of a third party or interferes with a third party's property rights, as opposed to their purely economic interest..."

Forest Giles had laid the vinyl floor prematurely before the screed had sufficiently dried out and the remedial work consisted of removing that defective vinyl relaying the underlying screed and laying fresh vinyl. No physical damage was alleged to have been caused to any adjacent or underlying works or any property of the developer, it was simply the position that the works performed by Forest Giles were defective and had to be redone. There was therefore no damage to property."

The Court of Appeal therefore concluded that the obligation on the part of the insurer to indemnify both the claimant and the defendant was dependent upon proof that the risk insured against, mainly damage to property, had in fact occurred. The Court of Appeal upheld the lower court's decision that it had not.

In summary, the cases in England strongly suggest that there will need to be a finding of some sort of *"physical change"* to the insured property before a finding of physical loss or damage will be made.

Looking at other jurisdictions, reference has already been made to the decision *Ranicar v. Frigmobile Pty* case where the Supreme Court of Tasmania considered a claim arising out of the alleged damage to a consignment of frozen scallops.[141] The court in reviewing the previous authorities held that "damage to" should be given the following meaning:

"A physical alteration or change, not necessarily permanent or irreparable, which impairs the value or usefulness of the thing said to have been damaged. It follows that not every physical change to goods would amount to damage. What amounts to damage depends on the goods."

There were clearly physical changes to the scallops in the sense of enzymic activity and chemical oxidation of the fats within them, but they were not such as to significantly affect the marketability, edibility or other material qualities of the scallops. The only loss suffered by the assured was because of the inability to export the scallops caused solely by the fact that they were stored at a temperature above -

[141] Cited with approval in *Quorum v. Schramm*

18°. Nonetheless, the court held that the alteration in temperature undeniably involved a physical change and had the effect of removing one of the primary qualities which the scallops had, their exportability. As a result, their usefulness was impaired and their value reduced and that this constituted damage under the Cargo Policy.

There is also an important construction insurance case from the Court of Appeal in New South Wales. In *Transfield Constructions Pty Limited v. GIO Australia Holdings Pty Limited*[142] the insured contracted to construct 30 grain silos at a terminal. The insurers insured the works against "physical loss or damage". Each silo was fitted with fumigation pipes, diffuser grids and channels that were employed for the purpose of dissipating fumigant throughout each silo and to control the spread of insects. Because of a fault in the design, grain was able to infiltrate into the fumigation pipes to the extent that the fumigation pipes beneath each silo became full of grain. In consequence of the blocking of the fumigation pipes, each silo could not be fumigated.

The question for consideration by the court was whether the blockage from the fumigation pipes by grain, so the fumigants could not escape from the pipes into the silos, constituted physical loss or damage. The argument of the Underwriters, which succeeded at first instance and on appeal, was that the mere presence of the grain in the pipes and the blockage did not constitute physical damage to the pipes but simply precluded the pipes from functioning in the manner intended. It was argued that there had to be damage of a physical type to the pipes i.e. there had to be some physical alteration or change in the pipes themselves to attract the words of the policy rather than the occurrence of events described as "external to the pipes". The court found for the defendant Underwriters.

The case went on appeal and in the leading judgment, Meagher J A held:

"No pipes were lost, no pipes were destroyed, no pipes were damaged. It is not contested that to remove the pipes and reinstall them would have caused financial loss to the plaintiffs. That is again beside the point. Mr Maconachie learned senior counsel for the appellant said the fact that the pipes were rendered useless constituted physical damage within the meaning of the policy. I do not think so. Loss

[142] 1997 9 ANZ Insurance Cases 61-366

of usefulness might in some contexts amount to damage, though even that is not beyond dispute but in my view, it cannot amount to physical damage. Functionality is different from physical damage. For these reasons which were substantially the reason given by His Honour below, I think the appeal should be dismissed."

The decisions in *Ranicar* and in *Transfield Constructions v. GIO Australia* were considered by the Court of Appeal in Victoria in *Switzerland Insurance Australia Limited v. Dundean Distributors Pty Limited*[143]. That case concerned cover in respect of "damage" (not physical damage) to computer equipment following a drop in the electrical power supply to a computer system. This led to a physical change to the magnetic alignment of the particles on the hard disc but the computer itself was undamaged. Costs were incurred in recovering the data and reinstalling it. The court approved the earlier decisions in *Ranicar* and *Transfield Constructions* but held, on the facts, that there had been a physical alteration to the insured electronic equipment, which had impaired both its value and usefulness. There also appears to be a clear indication that there could be a difference between "damage" and "physical loss and damage".

Finally, a couple of cases from the United States have also considered damage in this context. In *Community Antenna Services v. Westfield*[144] a policy defined damage as "physical injury to tangible property". Signal leakage from a cable installed by a TV company was found to be property damage of the signal because the signal's loss of strength could be measured and quantified.

In *Port Authority of New York v Affiliated FM*[145] the Court of Appeals (Third Circuit) held in case of property damage for the release of asbestos fibres, that "physical loss or damage" only occurs if the release results in contamination to the extent that the building cannot be used for the purpose it was intended, and that the mere presence of asbestos, or the general threat of damage would not trigger coverage under the policy.

[143] 4th March 1998
[144] 173 F Supp 2d 505, 511 (2001)
[145] 311 F 3d 226, 236 (3 Cir, 2002)

8.3 Risk & Fortuity

WELCAR is written on an all risks basis[146]. English law recognises that this is qualified in that all risks does not mean that all losses are covered. An insurance, by its terms, can also contain express exceptions or exclusions of particular risks.

English law also requires that, for the loss to be recoverable under an all risks wording, it must be fortuitous, which is sometimes described as being "accidental" or something which is not inevitable. At its simplest, this means that there must be some element of chance or inability on the part of the assured to foresee an event, which could not have been reasonably anticipated. An inevitable loss is one that is bound to arise and should be foreseeable.

A classic example of this is any material, which, by its inherent nature, will deteriorate if exposed to the elements, such that it could be interpreted to be lost as a result of inevitability if left without adequate protection. It was held by the House of Lords[147] that:

"All risks cannot of course, be held to cover all damage, howsoever caused. For such damage as is inevitable from ordinary wear and tear, inevitable depreciation is not within the policies…..damage, in other words, if it is to be covered by policies such as these, must be due to some fortuitous circumstance or casualty."

Loss or damage that is attributable to ordinary wear and tear or the ravages of time is not a fortuitous loss under an all risks policy. There is no need for the insurers to rely on a "wear and tear" exclusion in order to defeat such a claim.

The same applies to inherent vice, which is a defect in the subject matter tending to its loss, damage or destruction that was present at the time cover commenced and materialises during the period of cover. In the simple case, if such loss occurs during the policy period, it lacks fortuity in the sense that it was always going to happen, sooner or later, during the period of the cover.[148] This is why assureds failed to recover for losses caused by boiler explosions on steamships until the "Inchmaree Clause" came to be introduced as standard into hull policies.

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[146] WELCAR 2001 – Section I – Clause 1
[147] *British and Foreign Marine Ins Co v Gaunt* [1921] 2 AC 41

The question of the presence or absence of the necessary element of fortuity cannot be established without making assumptions about the information available to the assured and the time at which the certainty (or absence of fortuity) is to be established. It is obvious that all material things decay or deteriorate sooner or later. The appropriate test to be applied when considering whether a particular case falls outside all risks cover is not whether something will eventually happen, but whether the loss or damage will occur during the period of the policy.

One of the difficulties is whether the question of fortuity is to be looked at through the eyes of the assured or with the benefit of hindsight. In *Kier Construction v Royal Insurance (UK) Limited*[149], it was alleged that it was known or should have been known that certain temporary (but reusable) piles would be damaged during the course of construction. The court accepted that the assured knew that 5% of the piles could not be saved but, as to the balance, there was no expectation of damage. The court applied a subjective test, in that there was no evidence to show that the damage to the 95% of the piles was due to wear and tear. Even if, with the benefit of hindsight, the loss was inevitable, the loss was still an insurable loss because the parties did not expect the loss to occur.

8.4 Loss Notification

Section I – Physical Damage of WELCAR requires the Assured to render a signed and sworn proof of loss as soon as reasonably practicable after an occurrence stating the time, place and cause of loss, the interest of the Assured and of all others in the property, the value thereof and the amount of loss or damage thereto[150]. Section II – Liabilities requires the Assured to provide written notice to Underwriters as soon as is practicable stating the specific Occurrence, the damages which may result or have resulted from the Occurrence and the circumstance by which the Assured first became aware of the Occurrence[151].

The effect of an Assureds failure to comply with the terms of a notification clause will depend upon whether or not the obligation to notify is properly classified as a condition precedent to Underwriter's liability. If it is, then the Underwriters may repudiate the claim; if not, the claim must be paid, but the Underwriters will be

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[148] See: *Berk and Co Ltd v. Style* [1955] 2 Lloyds Rep 382.
[149] 30 Con LR 45
[150] WELCAR 2001 – Section I – Terms & Conditions - Clause 3

entitled to compensation for any loss sustained as a result of the Assureds breach of contract. Often such damages will be nominal only, but it is conceivable that the Underwriters may be put to additional expense if there is an inordinate delay in notification of a claim: for example, the circumstances surrounding the original event may be difficult (and therefore more costly) to investigate.

Claims notification provisions will not be construed as conditions precedent to liability unless clearly worded to that effect. This does not mean that the relevant provision has to be described as being a "condition precedent" before it can be construed as such but if it is so described (as they often are) there will be little room for doubt that the provision is in fact a condition precedent to liability.

In *Alfred McAlpine Plc* v. *BAI (Run-Off) Ltd*[152] it was accepted that a form of claims notification clause in an insurance policy was not a condition precedent. It was argued on behalf of the insurers that the insured's failure to notify a claim in accordance with the clause might establish a repudiation of the contract which the insurers could accept. The Court of Appeal held that the notification provision in this case was an innominate term, mere non-compliance with which could not amount to a repudiatory breach of the entire policy. The court added, however, that in principle a breach which evinced an intention on the part of the insured not to continue with the policy, or which had very serious consequences for the insurer, might entitle the insurer either to repudiate the claim or to be discharged from all liability under the policy.

The Court of Appeal in *Friends Provident Life & Pensions Ltd* v. *Sirius International Insurance*[153] appears to have narrowed the range of potential consequences flowing from the breach of a notification clause, where this is not expressed to be a condition precedent. The case involved a notice clause in an excess layer of a professional indemnity policy wording that was "essentially the same" as the clause considered in *McAlpine* v. *BAI*. At first instance[154] the Commercial Court held that, to the extent that it was not expressed to be a condition precedent, the clause should be construed as an innominate term, a sufficiently serious breach of which would entitle the insurer to refuse payment of the claim. The Court of Appeal agreed with the classification of the term as "innominate". The majority of the court (Waller LJ dissenting) considered, however, that if there had been a serious breach, insurers would have the right to

[151] WELCAR 2001 – Section II – Terms & Conditions – Clause 1
[152] [2000] 1 Lloyd's Rep IR 352 (CA)
[153] [2005] 2 Lloyd's Rep 517
[154] [2005] Lloyd's Rep 135

refuse the claim only by treating the policy as a whole as repudiated. They accepted that it would be hard to conceive of a breach which could lead to such a consequence. They refused, nevertheless, to imply a term that a serious breach of a claims condition could give insurers the right to reject a claim while treating the policy as a whole as valid.

The effect of the majority decision in *Friends Provident* v. *Sirius* is that if a condition is not classified as a condition precedent, practically speaking underwriters will have to pay the claim no matter how grave the assureds breach and no matter how seriously they have been prejudiced. The insurer's only remedy in most, if not all, cases would be damages. Calculation of such damages would be difficult, if not (as Waller LJ considered) illusory. In practice, it may be unlikely that underwriters will be awarded damages for breach of a notification clause, since any loss to them is likely to be highly speculative. The Court of Appeal observed, however, that underwriters are able to protect themselves from breaches of claims conditions by appropriate wording—in other words, by making notification clauses conditions precedent to indemnity.

The Court of Appeal's reasoning in *Friends Provident* v. *Sirius* has been followed in *Ronson International Ltd* v. *Patrick*[155]. On the facts of this case, it was held that a notification clause under a liability policy had not been breached—the policyholder was obliged immediately to notify a *claim*, but not necessarily an event which might give rise to a claim. The notification clause was not a condition precedent. The judge considered that, after *Friends Provident* v. *Sirius*, the only question was whether the insured had, by making a late claim, repudiated the policy as a whole. It was no longer possible to argue (as in *McAlpine* v. *BAI*) that insurers could escape liability by showing that breach of a notification condition had caused them serious prejudice.

Neither of the loss notification clauses in Sections I and II of WELCAR would be construed as a condition precedent to indemnity and accordingly a failure by an Assured to give proper notification is most unlikely to prove fatal. However having said that, it would still be prudent for an Assured to give prompt notification at the earliest available opportunity.

[155] [2006] Lloyd's Rep IR 194

8.5 Occurrence (Section I)

Earlier in this paper we noted that pursuant to the insuring clause, only "physical" loss or damage is covered and such a physical loss or damage must result from an "Occurrence".[156] We also observed that the various deductibles applied in respect of "each and every Occurrence"[157].

"Occurrence" means "one loss, accident, disaster or casualty or series of losses, accidents, disasters or casualties arising out of one event"[158]. As such, it is an "events based" provision. In England, the interpretation of such provisions has arisen for consideration primarily under reinsurance contracts, in which the reinsurer is obliged to pay in respect of, for instance, "each and every loss and/or occurrence arising out of one event" to be distinguished from a "caused based" clause such as "in respect of any claim or claims arising from one originating cause or series of events or occurrences attributable to one originating cause"[159].

An "event" was defined by the House of Lords in *Axa Reinsurance (UK) Plc v. Field*[160] as something which *happens* at a particular time, at a particular place, in a particular way.

A state of affairs or omission or a plan cannot constitute an "event". Therefore, the lack of appreciation by an underwriter of the consequences of asbestosis or of the effect of the LMX spiral[161] could not be an "event" giving rise to losses[162].

The event does not need to be the proximate or immediate cause of loss but there must be a causative link and it must be significant rather than weak[163]. The trend is to test the causation link by reference to what has become known as "the unities" test.

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[156] WELCAR 2001 – Section I – Clause 1
[157] WELCAR 2001 – Section I – Clause 5 of Declarations
[158] WELCAR 2001 – Section I – Definitions -Clause 1
[159] Such a clause was considered by the House of lords in *Axa Re UK plc v. Field* [1996] 1 WLR 1026
[160] [1996] 1 WLR1026
[161] In *Axa Re UK plc v. Field*, Lord Mustill described the LMX Spiral as "*the pathological outcome of writing whole account excess of loss in a narrow market [London], the essence being that the same loss might in certain events circulate through a chain or chains of reinsurances, repeatedly impacting on and ultimately exhausting successive layers of cover, leaving the reinsured without the intended protection or none at all.*"
[162] *Caudle v Sharp* [1995] LRLR 433; *Cox v Bankside* [1995] 2 Lloyd's Rep 437; *Scott v Copenhagen Reinsurance Co (UK) Ltd* [2003] Lloyd's Reports IR 696, 713.
[163] Scott v Copenhagen Re, *ibid* at para 63.

The unities test was developed in the *Dawsons Field* arbitration award [1972]. The award arose out of the hijacking of four aircraft in 1970 by members of the Popular Front for the Liberation of Palestine (PFLP). One plane was destroyed at Cairo and the remaining three at Dawson's Field in Jordan. The wording in question covered "*each and every loss...and/or occurrence and/or series of occurrence arising out of one event*".

The arbitrator concluded that the planes were not lost when they were hijacked, but when they were destroyed. If the hijacking had been the cause, the losses could not be aggregated because the aircraft were hijacked by different persons in widely separate localities.

After deciding that "occurrence" is more or less interchangeable with "event", he went on to state:

"*Whether or not something which produces a plurality of loss or damage can properly be described as one occurrence ...depends on the position and viewpoint of the observer and involves the question of degree of unity in relation to cause, locality, time and, if initiated by human action, the circumstances and purpose of the persons responsible...*

In my view, there was one occurrence, one event, one happening: the blowing up of three aircraft in close proximity, more or less simultaneously, within the time span of a few minutes, and as a result of a single decision to do so without anyone being able to approach the aircraft between the first explosion and their destruction".

A similar approach was adopted in *Kuwait Airways Corporation v. Kuwait Insurance Company SAK*[164]. The Court held that:

"*An "occurrence" (which is not materially different from an event or happening unless by chance the contractual context requires some distinction to be made) is not the same as a loss, for one occurrence may embrace a plurality of losses. Nevertheless, the losses' circumstances must be scrutinised to see whether they involve such a degree of unity so as to justify their being described as, or as arising out of, one occurrence. The matter must be scrutinised from the point of view of an informed observer placed in the position of the insured. In assessing the degree of unity,*

[164] [1996] 1 Lloyd's Rep 687

regard may be had to such factors as cause, locality and time and the intentions of the human agents".

This case concerned the loss of 15 aircraft belonging to Kuwait Airways Corporation following the invasion of Kuwait by Iraqi forces and the seizure of Kuwait Airport on 2 August 1990. The question was whether this could appropriately be described as one "occurrence". The Court held that there was unity of time, location, cause (the main contender being "seizure") and intent (the expropriation of the Kuwaiti national airline and all its property).

Relatively recent decisions which fell on the wrong side of the "unities" test include *Mann v. Lexington Insurance*[165] and *Scott v. Copenhagen Re*[166].

In *Mann v. Lexington,* the Court considered losses arising out of the deliberate orchestration of civil unrest by the Indonesian Government which resulted in riot damage to 22 supermarket stores in Jakarta. It was held not to be one occurrence as there were a number of individual riots which took place at different locations throughout Indonesia over the course of two days, such that there was no unity of time and place.

Scott v. Copenhagen Re was the sequel to the Kuwait Airways case. Apart from the 15 KAC aircraft taken by the Iraqi forces, there was a British Airways Boeing which had been delayed in transit and got stranded at the airport when Iraq invaded Kuwait. It was still there when "Operation Desert Storm" took place about 5 months later and got destroyed by allied bombing. The Court held that the loss of the British Airways plane could not be aggregated with the loss of the KAC aircraft as the unities test was not satisfied. There was no unity of time because the British Airways plane had not been seized at the beginning of the invasion along with the others. There was no unity of cause because the cause of the loss was not seizure by Iraqi forces, but actual destruction by allied bombing several months later. There was no unity of intent because taking the BA plane was not part of Saddam Hussein's plans to expropriate the Kuwait national airline and all its assets.

There is a wider kind of unifying factor than "event" or "occurrence". The House of Lords in *Axa v. Field*, contrasted an "originating cause" with an "event". Lord Mustill, who gave the leading judgment, said as follows:

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[165] [2001] 1 Lloyd's Rep 179
[166] [2003] Lloyd's Rep IR 696

"The contrast is between "originating" coupled with "cause"... and "event"... In my opinion these expressions are not at all the same, for two reasons. In ordinary speech, an event is something which happens at a particular time, at a particular place, in a particular way. I believe that this is how the Court of Appeal understood the word. A cause is something altogether less constricted. It can be a continuing state of affairs; it can be the absence of something happening. Equally, the word "originating" was in my view consciously chosen to open up the widest possible search for a unifying factor in the history of the losses which it sought to aggregate. To my mind the one expression has a much wider connotation than the other.".

However, it was still necessary to have some causative link and there must be some limit to the degree of remoteness acceptable.

In *Municipal Mutual Insurance Ltd v. Sea Insurance Limited*[167], a large piece of machinery had been left unguarded and unprotected on a dockside for some 18 months and progressively stripped during that period by a number of individuals or groups acting independently of one another.

The Judge noted that if the relevant clause was an "any one event" clause, each act of pilferage or vandalism could be said to be a distinct event. However, under the "original cause" clause, the losses fell to be aggregated because the acts of pilferage and vandalism were a series of occurrences attributable to a single source of cause, namely the inadequacies of the Port's system for protecting machinery.

Similarly, in *Cox v. Bankside*[168], the negligent approach of a Lloyd's Underwriter was held to be the "originating cause" of losses on a number of separate risks he had written on behalf of various Syndicates. However, it was held that the scope of the clause was not sufficiently wide to encompass a situation where a number of Underwriters were negligent in their underwriting, but each formed his own underwriting policy (insofar as he had one) and took his own underwriting decisions independently and from his own viewpoint. This case concerned three Underwriters who underwrote a number of separate policies negligently under an individual misappreciation. The Court held that there were three "originating causes".

[167] [1998] Lloyd's Rep IR 421
[168] [1995] 2 Lloyd's Rep 437