

Not a CAR crash

Despite recent judicial events, construction (all risks) insurers are not giving contractors a guarantee against defects in workmanship.

Following the Court of Appeal's decision in *Seele Austria GmbH & KG v Tokio Marine Europe Insurance Ltd* (7 May 2008), the construction (all risks) (CAR) market has been apprehensive about its possible exposure to contractors as a result of including a standard defects exclusion clause in policies.

The *Seele Austria* case concerned coverage under a combined contract works (construction all risks and third party liability) policy. The subcontractor claimed an indemnity for the cost of rectifying defective windows in a development in London's Paternoster Square. The insurers denied liability. At trial, Mr Justice Field decided there was no cover under the policy without accidental damage to the works. However, his ruling was overturned by the Court of Appeal.

Background facts

The claimant subcontractor agreed to design and install a series of "punched" windows. When the installed windows were tested for water penetration, though, they leaked. Consequently, stone cladding and internal finishes had to be opened up to allow access for remedial works to the windows.

The CAR policy

The policy provided that "contractors and/or subcontractors" were covered "in respect of any works... lost or damaged due to a defect in design plan or specifications materials or workmanship" to the extent provided for by memorandum 18(2) and (3).

Memorandum 18(2) excluded "the cost necessary to replace repair or rectify (a) insured property... which is in defective condition due to a defect in design plan specification materials or workmanship... ." There was a saving provision which said: "[memorandum 18(2)(a)] shall not apply to other insured property which is free of the defective condition but which is unintentionally damaged in consequence thereof... ". Memorandum 18(2) corresponds to a standard defects exclusion clause known in the construction insurance market as DE3 or limited defective condition exclusion.

Memorandum 18(3) read: "The insurers will additionally indemnify the insured in respect of intentional damage necessarily caused to the insured property ... to enable the replacement, repair or rectification of insured property... which is in a defective condition... ." This indemnity was subject to a deductible for the first £10,000 "of the cost of each and every occurrence or series of occurrences arising out of any one event".

The issues

The main issue was whether memorandum 18(3) operated as a free-standing additional item of cover, or whether it was conditional upon memorandum 18(2), which required some accidental loss or damage. Could the claimant recover for damage intentionally caused to the stone cladding and internal finishes in order to allow access to replace the windows?

A second issue was whether the retained liability limit applied to the deficiencies in respect of each individual window (as the insurer contended), or whether there was a single deductible (as the claimant contended).

The Court of Appeal decision

It was held, by a majority, that memorandum 18(3) was a standalone indemnity and not subject to the operation of the rest of the clause. Therefore, even without any accidental damage, an assured was covered for damage deliberately caused to the works to gain access to remedy defects.

However, a separate deductible applied to each defective window. It could not be said that the repeated instances of poor workmanship arose "out of a single event". This was an important finding: multiple deductibles in respect of the numerous windows could substantially reduce the value of the claim.

Discussion

It is widely assumed that there needs to be some form of accidental damage to the works before a CAR policy will apply. Yet, here, a subcontractor was able to recover certain costs even though the defects had not yet produced any damage. This result alarmed underwriters.

However, the case was decided largely on the particular wording of the policy. Importantly, the Court of Appeal confirmed that the claimant would

not have been able to claim under memorandum 18(2) (a standard DE3 clause). As far as the defective windows were concerned, memorandum 18(2) would not have applied because the faulty sealing had yet to cause damage to any other part of the works. Lord Justice Moore-Bick rejected the claimant's argument that pinholes in the sealing membrane constituted "damage": this was "part and parcel of inherently faulty workmanship".

The decision confirms that it is paramount that the policy wording is clear about what is - and what is not - covered. If the intention in *Seele Austria* was to make the indemnity for access damage conditional on damage to which memorandum 18(2) applied, an error was plainly made in the numbering of the clause.

The case also provides guidance on deductibles. Repeated cases of bad workmanship (affecting, for instance, all the electrics or the windows) do happen. The decision establishes that a series of mistakes does not necessarily constitute "one event" under a standard retained liability clause. The result would have been different, however, had the mistakes been attributable to a single event "such as giving the workmen wrong instructions... conscientiously followed so as to produce a series of similar defects".

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