

PI Insurance for Construction Projects

The Third Runway – Sydney Airport

The following is an example of a major construction project that had latent defects which were not discovered until some time after the construction phases. The importance of proper insurance coverage is evident from the facts below.

Background

In 1992, the Federal Airports Corporation, the predecessor to Sydney Airport Corporation Limited (“Sydney Airport”), entered into a contract with Baulderstone Hornibrook Engineering (“Baulderstone”) for the design and construction of the third runway at the Sydney airport.

Baulderstone constructed the 7 kilometres retaining wall along the third runway at the airport in 1994 at a cost of \$200 million. Within a year of the completion of the construction, it became evident that there were subsidence problems with the seawall and retaining walls (“the walls”). The walls were supposed to be maintenance free and lasting for a period between 50 to 100 years. Instead, sand was blowing out between the joints into Botany Bay.

The walls were constructed with prefabricated concrete facing panels. The joints between the panels were sealed with geotextile through which water, but not sand, could flow. Behind the concrete panels were sand backfill which was required under the contract to be compacted to a uniform 80% density.

In 2002, Sydney Airport brought legal actions against Baulderstone in respect of the loss of the sand. These proceedings were settled in 2004 on the basis that Baulderstone would rectify the walls. The estimated cost for carrying out the rectification works exceeded \$60 million. The rectification costs were funded by Baulderstone’s parent company, Bilfinger Berger.

Insurance Claims

After the settlement with Sydney Airports, Baulderstone sought to claim indemnity under its project specific multilayered professional indemnity liability policies for approximately \$50 million from its insurers, including HIH, Gordian Runoff, QBE, CGU, and Lloyd’s of London. They settled their claim with certain insurers including Lloyd’s syndicates and QBE Holdings (Australia) for approximately \$30 million. HIH, the lead insurer, had admitted liability but failed to pay its \$20 million share of the claim.

Two of the insurers - Gordian Runoff Limited (in relation to a policy originally issued by GIO Insurance Limited) and CGU Insurance Limited (in relation to a policy originally written by Commercial Union Assurance Company of Australia Limited, trading as Pacific Indemnity) denied indemnity under the policy and were sued by Baulderstone.

The primary issue in the proceedings was the cause of the loss of sand from the walls. Baulderstone had asserted that it was due to negligent design. Connell Wagner and Reinforced Earth, who were Baulderstone's sub-contractors, designed the walls. Baulderstone alleged that they were negligent in prescribing the use of geotextile. The insurers had submitted that the cause of the loss was not negligent design but, instead, defective workmanship in the construction of the backfill by Baulderstone.

The Outcome

At the end of the day, based on the facts and the particular wording of the professional indemnity liability policy, the court held that the loss was caused by defective workmanship and therefore the insurers were entitled to deny indemnity. The court said that the loss was caused not so much by the use of the geotextile but by the failure of Baulderstone to take appropriate steps during the compaction of the sand backfill to ensure that this compaction would not adversely affect the geotextile.

The court also made some interesting remarks about the wording of the exclusion clause which provided that the insurers were entitled to deny indemnity in respect of claims:

“arising out of construction work performed involving the means, methods, techniques, sequences, procedures and use of equipment, of any nature whatsoever which were employed by the Insured’s contracting staff or others in the executing of any phase of any project.”

This exclusion had the effect of excluding coverage, the court said, in circumstances where it is not necessary for the insurer to prove that the construction work was negligently performed; nor does it matter that the construction work was in accordance with the plans and specifications for the performance of the works.

This case shows the importance of the actual policy wordings of professional indemnity liability policies in major construction projects. One cannot be over cautious in checking the wordings, particularly the exclusion clauses to ensure a proper understanding of the scope of coverage. The costs of rectification works in major projects are often extremely high and the reality is that, in the context of a design and construct contract, negligent design will most often manifest itself in the construction works which conforms to that design.

At least Baulderstone were able to recoup part of their rectification costs in their settlement with other insurers who settled their claim with Baulderstone. The total loss to the insured was in the vicinity of \$65 million.

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