IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2007-485-74

BETWEEN	ARROW INTERNATIONAL LIMITED Third Defendant
AND	QBE INSURANCE (INTERNATIONAL) LIMITED Seventh Third Party

Hearing: 4 - 8 May 2009

Appearances: M A Pembroke SC, (of the New South Wales bar) and P H Thorp, for Third Defendant
M G Ring QC, L J Taylor and S D Galloway for Seventh Third Party

Judgment: 23 June 2009 at 3.15pm

I direct the Registrar to endorse this judgment with a delivery time of 3.15pm on the 23rd day of June 2009.

RESERVED JUDGMENT OF MACKENZIE J

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See paras 20, 94 and 95 for "stigma"

Introduction

[1] Luxford Villas is an apartment complex in Berhamphore, completed in 2000. It was a leaky building. Problems first became manifest in 2003. The apartment owners issued proceedings in 2007 against a number of parties including Arrow International Limited (Arrow), the design and build contractor. The proceedings were settled in September 2008, on terms involving a substantial payment by Arrow. Arrow had, for part of the period, a general liability insurance cover with QBE Insurance (International) Limited (QBE). It had joined QBE as a third party in the proceedings. The remaining issue in the proceedings is Arrow's claim against QBE for indemnity under the policy in respect of the settlement sum paid by it.

The insurance cover

[2] Arrow first took out a general liability policy with QBE for the period 30 May 2002 to 30 May 2003. It was renewed for the following years, to 30 May 2004,

and to 30 May 2005. The policy covered Arrow and subsidiary companies. Arrow's business was described as "planning and project managers, building contractors property owners and developers, tourist operators and any other activity connected therewith". A number of different limits of indemnity and deductibles were specified for different circumstances. There are other provisions in the policy to which I will need to refer, but the essential terms of coverage under the policy were contained in the provisions which follow.

[3] The policy provided indemnity for damages, and for claims costs, in the following terms:

> **INDEMNITY FOR DAMAGES**
>
> The Company will indemnity the Insured in respect of all sums that the Insured becomes legally liable to pay by way of compensation consequent upon:
>
> (a) accidental physical loss of or damage to any tangible property;
>
> (b) accidental loss of use of any tangible property not otherwise lost or damaged;
>
> (c) accidental death or bodily injury or illness (including shock, fright, mental anguish or mental injury) to any person;
>
> (d) false arrest, wrongful detention, false imprisonment, wrongful eviction, malicious prosecution, malicious humiliation, libel, slander, invasion of privacy, wrongful entry, wrongful prevention of access, assault or battery not committed by or at the director of the Insured unless committed for the purpose of preventing or eliminating danger to any person or property, or any of them;
>
> happening within the Territorial Limits specified in the Schedule during the Period of Insurance and resulting from Occurrences in connection with the Business.
>
> The Company's liability under the Indemnity for Damages clause for all sums payable to all claimants in respect of any one Occurrence (or if so specified, in the aggregate in respect of all occurrences of Damage or Injury during the Period of Insurance) will not exceed the applicable Limit of Indemnity specified in the Schedule.
>
> **INDEMNITY FOR COSTS**
>
> The Company will pay or will indemnify the Insured in respect of any claim or action to which the Indemnity in this Policy applies for:
>
> (a) all costs incurred by the Company, all costs recovered by any claimant against the Insured, and all interest accruing after entry of

judgment until the Company has paid or deposited in court as much of the judgment as does not exceed the applicable limit of the Company's liability;

(b) all reasonable costs, other than loss of earnings, incurred by the Insured with the Company's consent

[4] Three definitions in the policy are of particular relevance:

'Damage' means any event described in (a) or (b) of the Indemnity for Damages clause.

'Occurrence' means an occurrence resulting in Damage or Injury and includes any one occurrence or a series of occurrences (including continuous or repeated exposure to injurious conditions) consequent upon or attributable to one source or original cause.

'Products' or 'Product' means any property and any container of the property (the container not being a Vehicle) manufactured, constructed, erected, installed, repaired, serviced, treated, renovated, sold, supplied or distributed by the Insured, after the property has ceased to be in the Insured's possession and control.

[5] There was one relevant exclusion:

Defective Products

This Policy does not insure against liability for the cost of rectifying any defect in any Product, or the cost of repairing or replacing or making any refund of the price paid for any Product, by reason of the product having proved defective, harmful or unsuitable for its intended purpose.

[6] Those are the principal relevant terms of the policy as to cover for the 2002/03 and 2003/04 years. For the 2004 to 2005 year, a further exclusion was added, in the following terms:

BUILDING DEFECTS

This policy does not insure against liability consequent upon Damage or Injury arising directly or indirectly out of:

1. the failure of any building or structure to meet or conform to the requirements of the New Zealand Building Code contained in the First Schedule or the Building Regulations 1992 or any applicable New Zealand Standard (or amended or substituted regulation of standard) in relation to leaks, water penetration, weatherproofing, moisture, or any effective water exit or control system;

2. mould, fungi, mildew, rot, decay, gradual deterioration, micro-organisms, bacteria, protozoa or any similar or like forms, in any building or structure.

The apartment owners' claims against Arrow

[7] Arrow was the head contractor for the development, responsible for both the design and construction of Luxford Villas. It did not itself carry out either the design or any of the construction. All work was subcontracted. Construction commenced in November 1999, the building was closed in by the end of October 2000, and practical completion occurred in December 2000, subject to correction of defects, a process which continued for some two years.

[8] In August 2003 a tile on the deck of one of the units collapsed while being walked on. Investigation revealed extensive rotting and water damage to timber in the deck. As a result of more extensive investigation following that incident Arrow caused work to be carried out on the decks along the eastern side of the building. That work was completed in late 2004.

[9] In early 2006, the body corporate which owned the building engaged consultants to investigate continued rotting, water damage, and leaking to the building. In January 2007 the body corporate and unit owners commenced proceedings against a number of parties, including Arrow, in which they alleged breaches of duties of care owed by Arrow to them. They claimed damages calculated by reference to the estimated cost of remedial work and various other items. Arrow took the view that it did owe the duties alleged by plaintiffs and that if the defects and damage were substantiated Arrow was legally liable to the plaintiffs for their remedial costs. The principal difference between the plaintiffs and Arrow was the scope of the necessary remedial works, in particular, whether a targeted repair would suffice or whether full replacement of the balconies, walkways, cladding and joinery was required. The plaintiffs would not permit Arrow to carry out further remedial work itself, and they could not afford to engage other contractors until damages were recovered from Arrow. Accordingly, negotiations had to proceed on the basis of an estimate of the scope of the work, although the true extent of that could not be determined until all the cladding and tiling to the decks and walkways had been removed.

[10] The parties achieved a settlement at a mediation in September 2008, after an earlier unsuccessful mediation. Arrow agreed to pay $5 million to the plaintiffs. That was subject to a number of recoveries from other parties which reduced Arrow's liability to $3.78 million.

The pleadings

[11] The original statement of claim by Arrow against QBE, issued with the third party notice, pleaded the terms of the policy (without reference to the particular year of cover) and sought relief against QBE in these terms:

> (a) Indemnity for any of the losses to which the Plaintiffs might prove to be entitled to be compensated for by Arrow or for which the First and Second Defendants might prove to be entitled to be indemnified, save for the cost of rectifying any defect in any property constructed, erected or installed by Arrow.
>
> (b) Indemnity for QBE for any costs and interest payable by Arrow to any other party to this proceeding.

[12] When this matter was first scheduled for trial in November 2008, Arrow sought leave to amend the statement of claim in a number of respects, in particular to add a claim that QBE had repudiated the policy. At the start of the trial, I granted leave to file the amended statement of claim, and adjourned the hearing, for reasons which I set out in my judgment of 4 November 2008. The amended statement of claim, filed pursuant to that leave, pleaded that Arrow was entitled to indemnity under the policy. It further pleaded that QBE notified Arrow in May 2007 that it accepted that the building owners' claim against Arrow were within the scope of cover under the policy save for certain claims allegedly excluded by the defective products exclusion. It pleaded that notwithstanding Arrow's entitlement to indemnity and QBE's acknowledgement, QBE had failed to indemnify Arrow and said:

> By QBE's failure at all material times to pay to Arrow the whole or any part of its liability to the plaintiffs and the whole or any part of the defence costs, QBE has breached its obligations under the Policy and is liable to indemnify Arrow pursuant to the Policy or to pay damages to Arrow in the same amount.

[13] The amended statement of claim went on to plead as an alternative that QBE had evinced an intention no longer to be bound by the policy and had thereby repudiated the policy and was liable in damages. Mr Pembroke SC for Arrow indicated during the course of opening that that alternative claim of repudiation was withdrawn.

The issues

[14] The essential matters in contention between Arrow and QBE turn on several key questions as to the coverage of the general liability policy for the relevant periods. The issues may be briefly summarised.

(a) Policy coverage for damages

[15] Arrow's principal contention is that the total sum of $3.78 million paid in damages is covered under the insuring clause for indemnity for damages. It submits that there are no relevant exclusions.

[16] QBE contends that it has no indemnity obligations to Arrow at all. It submits that in May 2002 when it came on risk the physical damage to the building had already occurred and reached a stage that the scope of the remedial works then necessary was essentially the same as that ultimately agreed as necessary. Alternatively, QBE says that if there was any difference in the positions as at May 2002 and that ultimately agreed, QBE would only have been liable in respect of that difference, and that Arrow has not advanced any case on that alternative basis.

[17] QBE further says that if Arrow has established a liability within the scope of the operative clause, the defective products exclusion applies. It submits that the effect of that exclusion is to exclude indemnity for that part of the settlement sum which is attributable to remedial works.

[18] There is one aspect which I need to mention briefly. By a letter dated 7 May 2007, QBE had set out its position on indemnity. It accepted that some aspects of

the losses claimed were covered by the policy and not excluded by the defective products exclusion. It offered $50,000 in full and final settlement. That offer was not accepted. In these circumstances, QBE is not precluded by its earlier acknowledgement that there were some losses covered from now contending that none of the losses are covered.

(b) Quantum

[19] It is common ground between the parties that if Arrow succeeds on its principal contention, namely that the claim is covered by the operative clause in the policy and the defective products exclusion does not apply, then the sum insured is (subject to the policy deductible of $50,000) the total net settlement sum paid by Arrow of $3.78 million.

[20] In the event that Arrow succeeds on its contention that the claim is covered under the general insuring clause, but QBE succeeds in its claim that the defective products exclusion applies, the parties differ as to the effect of that on quantum. The essence of the difference between them is this. The plaintiffs' claims against Arrow totalled approximately $9 million, for remedial costs, relocation costs, stigma damages, general damages, exemplary damages, consultants' fees and other minor items. Arrow contends that in determining how much of the $5 million settlement sum should be attributed to remedial costs, all of the heads of damage claimed by the plaintiffs should be reduced rateably, so that the amount attributed to remedial costs in the settlement should be five ninths of the plaintiffs' claim for remedial works. QBE submits that there should be a more targeted assessment of the settlement, and that items which were less likely to succeed, and accepted by the plaintiffs as less likely to succeed, such as exemplary damages and stigma damages, should be excluded in apportioning the $5 million settlement figure for remedial works and other heads of damage.

(c) Policy coverage for costs

[21] At the start of the hearing, there were significant differences between the parties on the quantum of Arrow's costs of defending the plaintiffs' claims, under the indemnity for costs cover. In the course of the hearing, the parties were able to resolve some issues. It is common ground that any liability under the policy for costs is dependent on there being a liability for the damages component of Arrow's claim. As matters now stand, Arrow claims that it is entitled to indemnity for the full amount of defence costs incurred by it, the quantum of which it has agreed with QBE at $1 million. QBE accepts that quantum, but submits that Arrow has not satisfied the contractual pre-condition of obtaining QBE's consent to the incurring of those costs, so that it is not entitled to recover costs.

[22] In the event that the defective products exclusion applies, the parties have agreed that the portion of the total $1 million costs which is attributable to the insured losses is $725,000. QBE's submission, that no sum is recoverable because QBE's consent was not obtained, is maintained in this eventuality.

The damage

(a) The nature of the damage

[23] Counsel for Arrow in opening described the damage in these terms:

> With immaterial exceptions, the damage consisted or rotting and water damage to timber. Rotting and water damage to timber is an ongoing process of microbiological decay. It develops over time. It occurs at a microscopic level, and will not usually be readily detectable until failure of the timber occurs. In that sense, rotting and water damage to timber is latent or incipient damage that does not become manifest unless and until the ongoing process of microbiological decay results in physical injury or damage to tangible property.

[24] That description highlights the crucial question: does the damage fall within the expression "physical damage to tangible property happening during the period of insurance" – that is, after 30 May 2002? To answer that question requires a close

analysis of the evidence as to the damage, and the application, in the light of that analysis, of the policy wording.

(b) The evidence

[25] Two experts, Dr Wakeling and Dr Spiers, gave evidence as to the scientific nature of rotting and water damage. The following description of the process is essentially common ground. Rotting and water damage is a process of microbiological decay. All wood and wood products are susceptible to microbiological decay in the event that moisture contents close to the fibre saturation point occur. For radiata pine, that is close to 30%, but a 20% moisture content is a widely accepted minimum threshold below which decay is prevented. When the moisture content is close to the fibre saturation point the wet wood is adversely affected by a plethora of different types of fungi, bacteria, actinomycetes and insects and other arthropods. Many fungi cause no visible or structural issues and can only be detected with a microscope. Some fungi cause discolouration of building materials only. Some fungi may adversely affect the health of occupants and others. A very small proportion of the micro-organisms found on wet wood cause serious structural damage some of which are difficult to identify. These highly specialised fungi produce various combinations of hydrolytic and oxidative enzymes and smaller molecular weight substances such as free radicals and acids that break down the structural components of wood cell walls.

[26] The decay fungi typically arrive on wood in buildings as microscopic air borne spores. If a sustained elevated moisture level occurs microscopic threads called hyphae grow out from spores and proliferate wherever there is moist wood and no limiting factors preventing growth. Typically, decay fungi invest a substantial amount of time and energy in colonisation of wood before significant decay occurs. The time delay or lag phase depends on the amount of fungal infection nearby, the type of decay fungus or bacterium and the environment as defined by the type of wood product, its usage situation and the nature of water leakage. It typically takes many months for the fungal spores to become well established in wood products even if the wood has no inherent durability. Wood's

inherent susceptibility to degradation is due to an abundance of carbon sources that fungi use as a food source. Wood is also an attractive substrate for colonisation by fungi because it contains a myriad of inter-cellular spaces and other nooks and crannies that provide purchase and protection for spores. The rate at which decay occurs varies depending on the type of wood product and where it is used; the building faults that give rise to elevated moisture levels; and the type of organism causing the decay.

[27] The essential area of contest between the experts was the speed at which the decay process would have occurred, and consequently the level of decay which would have been reached by different times, in particular, by 31 May 2002 when cover incepted.

[28] Dr Wakeling was called by Arrow. His evidence was that, following the date of the building enclosure, at which date the defects permitting water ingress were present in the building, it would have taken approximately six months for moisture to accumulate near points of ingress. He said that there would be a phase of approximately six months following that during which decay would have begun to develop to a stage where it began to be well underway. He expressed the view that structural failure was caused by an advanced stage of at least two fungal decay types, white rot and brown rot.

[29] Dr Wakeling's inspections, coupled with photographs and related information concerning the timing of the initial structural failure at unit 204 referred to in paragraph [7], provided a clear insight to him into the history and timing of the rotting and water damage at Luxford Villas. He said that radiata sap wood, as used here, has a highly predictable life span once conditions for decay arrive and are then sustained. He said that if the end point of recent decay damage can be established and it is known that moisture was largely sustained at levels conducive to decay prior to this, it is a relatively straight forward scientific exercise to establish when the bulk of the damage occurred relative to the pre-determined end point.

[30] He said that in this case a key end point was clearly identified in the photographs of the damage to unit 204. He expressed the opinion that the building

faults would in all likelihood have led to serious moisture ingress within the first year after enclosure at nearly all balconies and walkways. He expressed the opinion that it is probable that the bulk of the damage occurred within an 18 month period prior to the structural failure in September 2003. He also said that damage prior to 30 May 2002 would inevitably have been much less significant albeit this was, in his opinion, an important period of gestation. He said that approximately 10% to 25% of the damage is likely to have been caused by that date. His investigations left him in no doubt that major structural damage of a type similar to that at unit 204 was reproduced throughout Luxford Villas in a similar timeframe.

[31] Dr Spiers (called by QBE) said that the speed of wood decay is affected by several factors including the wood type, moisture, temperature, and the aggressiveness of the decay fungi involved. Of these the most important factor is the wood. He expressed the opinion that at Luxford Villas there would have been few constraints to fungal decay. He said that once decay has started it continues until the wood substrate has been completely colonised and all the food has been consumed at which stage the wood is completely lacking in structure and total strength is lost. Not all of the wood would necessarily decay at the same rate. In his opinion the lag before moisture accumulated was likely to have been significantly less than the six months given by Dr Wakeling and probably around three months. Dr Spiers considered that the reduction in wood strength likely to have been lost by the end of May 2002 was probably up to 50%.

[32] It is accordingly common ground between the experts that the process of microbiological decay of the timber had commenced prior to 30 May 2002 and that it continued progressively over a period which extended both before, during and after, the relevant period of insurance. I find, on the basis of their evidence, that that is so. There is a measure of disagreement between them as to the stage which the decay would have reached by the commencement of the insurance coverage on 30 May 2002. I return to that issue at paragraph [83]. I find that the damage which has led to the need for remedial work is the result of a process of decay which has been continuous from a point in time prior to the inception of the relevant policy to a point after the end of the relevant policy period.

[33] The evidence also addressed the way the damage caused by the decay process became apparent. The first indication of a serious problem came in September 2003, when a tile on the deck of unit 204 collapsed while being stood on. Arrow was called in by the body corporate building owner to investigate. The investigation was described in a report prepared in November 2003. The author of that report was not called as a witness, but the report was produced in evidence and was accepted by the parties as factually correct. The tiles were lifted in a small area over the affected area. Upon lifting the membrane lining under the tiles, the plywood under the membrane was found to be completely rotted and in a very dangerous state. As the area was more fully exposed, extensive rotting in both the plywood and the timber framing of the deck was found. Wet rot had caused extensive damage to the timber at the base of the parapet wall and to floor joists at the location. Dry rot had affected the rest of the joists closer to the main apartment exterior wall. The damage was considered to require the complete removal of the affected timber, the treatment of all timber not yet affected, and the rebuilding of the deck.

[34] Remedial work carried out following that report did not resolve all issues to the satisfaction of the building owner, and a consultant, Mr Wutzler of Helfen Ltd, was engaged in about March 2006. He was called by Arrow as a witness in these proceedings. He carried out several extensive inspections, particularly related to damage caused by water ingress. He had prepared a substantial defects chart and scope of works required which formed the basis of the plaintiffs' claims at mediation. He described the defects in evidence as substantially comprising:

(a) Decay of timbers particularly of structural members, substrates and other timbers of the balconies, balcony balustrades, walkways and beams;

(b) Corrosion of the light steel framing;

(c) Degradation of the fibre cement sheet cladding system, building underlay and waterproof membranes.

The damage, in his opinion, arose from a lack of reasonable care in the design or construction of the building and to his observation was not attributable to the use of defective building products.

[35] Mr Hazlehurst is a building consultant called by QBE. His first involvement with Luxford Villas was in June 2008, when Mr Wutzler (then acting for the owners of Luxford Villas) sought his assistance and advice. After an initial inspection, that was not pursued further. In September 2008 he became involved as a consultant to the roofing contractor, which was also a party to the litigation and the mediation. He inspected the property again in April 2009 after being instructed by QBE.

[36] The principal area of difference between Mr Wutzler and Mr Hazlehurst was the time that it would have taken for water ingress to occur after construction. Mr Hazlehurst expressed the opinion that any breach of the water-proofing membrane would have allowed water ingress from the first time there was significant and sustained rainfall on the defective balconies and walkways. Mr Wutzler said that many of the defects would not on their own have caused water ingress, and that most of the defects, although present on construction, required a period of time for the conditions conducive to water ingress to manifest themselves. I return to this issue at paragraph [83].

[37] Mr Wutzler said that the scope of works required would have been substantially the same whenever the problem was addressed, unless the defects had been identified very early before there was any manifestation of their existence. In cross-examination, he agreed that if fungal decay had got beyond the very early stage, so that there was widespread fungal decay, the scope of works required would have been similar to that taken into account in the settlement with the building owners. Mr Hazlehurst agreed that the scope of work would have been the same whenever the problem was addressed. He said that the extent of decay would, in his opinion, have made that scope of work necessary before 30 May 2002.

[38] That brief description of the evidence as to the nature and extent of the damage demonstrates that it has two features which are particularly relevant to the way in which the policy addresses that damage. These are:

(a) The damage was continuous, in that it was the result of a continuous and gradual process of decay; and

(b) The damage was latent, in that the decay was of components within the internal fabric of the building, hidden from view unless there was cause to remove items covering these components.

[39] It is necessary, in considering the application of the policy, to address the way in which the policy wording is intended to address each of these features of the damage.

Coverage under the indemnity for damages clause

(a) One trigger point or a continuous trigger?

[40] Stripped to the essential wording relevant here, the coverage under the operative clause is that QBE will indemnify Arrow in respect of all sums that Arrow becomes legally liable to pay by way of compensation consequent upon accidental physical damage to any tangible property happening during the period of insurance and resulting from an occurrence. The word "occurrence" is a defined term, as set out in paragraph [3] above.

[41] It is common ground that Arrow has become legally liable to pay the settlement sum. It is, speaking broadly, also common ground that that liability was consequent upon rotting and water damage to timber in Luxford Villas. It is not contended that the damage was not accidental. Nor or is it in issue that the damage resulted from an occurrence. The essential question is whether it was damage "happening during the period of insurance".

[42] In opening, counsel for Arrow submitted, as the primary submission, that there are three possible answers to the question: was physical damage to tangible property happening during the period of insurance? These were:

(a) The orthodox approach is that the relevant date is the date of manifestation.

(b) An equally appropriate approach, having regard to the language of the insuring clause in this policy, is that the damage was "happening" during the policy period.

(c) On any approach it would not be reasonable to conclude that no material damage was happening during the policy periods 30 May 2002 to 30 May 2004.

[43] The approaches in these suggested answers involve the attribution of different senses to the word "happening". The first approach is premised on the proposition that the words "happening during the period of insurance" are to be understood as referring to a particular point in time, and that it is necessary to identify that point of time with sufficient precision to determine whether it is within or without the policy period. The second and third approaches are premised on the proposition that the words "happening during the period of insurance" may include a continuing state of affairs and so could encompass the possibility that some damage occurs within the policy period and some outside it. On the first approach, it would be necessary to determine one single event or circumstance which triggers coverage under the policy. On the second and third approach it would not be necessary to determine one single event or circumstance. Such an approach can for convenience be referred to as a continuous trigger approach, in that coverage would be triggered successively as damage is progressively suffered.

[44] A continuous trigger approach does, as Mr Ring QC for QBE submitted, provide the greatest access to the insurance coverage, and its adoption may arise from the application of public policy considerations to insurance policy interpretation questions. He refers to Hilliker, Liability Insurance Law in Canada (2nd Edition), where the author says (at p 155) "the continuous exposure theory may be favoured for reasons of public policy, in that by involving a number of insurance policies the greatest amount of coverage will be brought to bear in a particular case." The question here is whether policy considerations should, as a matter of law, tend to favour a continuous trigger approach.

[45] The continuous exposure (or multiple trigger) approach has not been widely adopted in insurance law. It has been applied in the United States in liability policies covering liability arising from latent personal injury from exposure to toxic products. In *Keene Corporation v Insurance Company of North America* (1981) 667F 2nd 1034, the U.S. Court of Appeals, DC Circuit, held that the general liability policies of a manufacturer using asbestos products were, on the wordings of these policies, triggered both by exposure to asbestos and by manifestation of the disease. The result was that each insurer on risk between the initial exposure and the manifestation of the disease was liable. A pro-rata apportionment among insurers was required. There was clearly, in the reasoning of the Court, a significant public policy element.

[46] However, even in the United States, the use of this multiple trigger approach appears to be limited to the specific situation of asbestos related disease. In an article to which counsel for Arrow referred: "When Does an Occurrence Occur? Determining Coverage in Latent Property Damage" (M A Kirsnher, (the Pamic Pulse volume 31 number 6) the author, in discussing the continuous exposure theory, says "while one may argue that our hypothetical case of latent property damage is not unlike one involving latent injury from exposure to toxic products, there is no case which so holds. Indeed, there is a steady line of Federal Court cases which reject this argument and conclusively hold that Pennsylvania does not apply a multiple or continuous trigger theory, except in cases of creeping disease."

[47] No cases from other jurisdictions where a continuous or multiple trigger theory has been applied were cited. The point was explicitly addressed by the English Court of Appeal in *Bolton Metropolitan Borough Council v Municipal Mutual Insurance Limited* [2006] 1 WLR 1492 at paragraph [24] in these terms:

> What Mr Palmer did argue, however, was that English law should follow decisions in other jurisdictions. It is well known that there are decisions in the United States, stemming from *Keene Corpn v Insurance Co of North America* (1981) 667 F 2d 1034, which have decided that all insurers at risk from the time of first exposure to the diagnosis of disease should be liable to the insured. I am far from saying that what has been called this multiple trigger or, sometimes, triple trigger theory (exposure, development of disease, and diagnosis) might not be held, on some future occasion, to be appropriate for employers' liability policies in general, depending on the precise words used. But, as far as public liability policies are concerned with the specific wording used in the present cases, I see no need for the English

> courts to adopt the multiple trigger theory. It has been adopted in the United States avowedly for policy reasons in relation to the vastly greater numbers of asbestos-disease sufferers in that country. I see no reason to adopt it in this particular case where the same policy considerations are not present.

[48] I do not consider that there are public policy considerations which should influence the interpretation of the words which the parties have used in the contract they have entered into. The words are to be interpreted according to the intention of the parties, not influenced by public policy considerations which might favour one interpretation over another.

[49] When the ordinary meaning of the word "happening" in this policy is considered in this way, I consider that its intention is to fix a single point at which coverage under the policy is triggered. While that particular word ending for the verb may in some usages connote continuity, the ordinary usage of that form of the verb in the phrase "damage happening in the policy period" is also consistent with something happening at a particular point in time during the policy period. I do not consider that a continuous trigger approach is provided for by the policy wording here. I consider that it is necessary to identify a single event or circumstance by which policy coverage is triggered.

(b) The possible single trigger points

[50] To determine what that single trigger is in this case requires consideration of the effect of the latency of the damage which arises from the fact that the damaged timber is covered up. Two competing contentions are advanced. Counsel for Arrow submits (on the first approach referred to at paragraph [42]) that the trigger is the date of manifestation of the damage. Counsel for QBE submits that the trigger is the point when the damage occurred, not when it became manifest. Counsel for QBE refers to these respective contentions as "manifestation" and "injury-in-fact". That is a convenient terminology, which I adopt. It is necessary to decide, in the light of the authorities and the policy wording, which is correct.

(c) The authorities

[51] Counsel for Arrow submit that manifestation is supported by authority, in reliance on *Axa Global Risks (UK) Ltd v Haskins Contractors Pty Ltd* (2004) 13 ANZ Insurance Cases 61-611. He also relies upon the article by Kirsnher to which I have referred.

[52] Counsel for QBE submits that injury-in-fact is supported by authority: *Bolton Metropolitan Borough Council v Municipal Mutual Insurance Limited; Allstate Insurance Company of Canada v Axa Pacific Insurance Company* [1998] CANLII 3912; *Dow Chemical Company v Associated Indemnity Corporation* 724 F.Supp. 474 (1989); and *Maryland Casualty v W A Grace and Company* 23 F.3D 617 (2nd Cir. 1993). Counsel also seeks to distinguish *Axa Global Risks*.

[53] *Axa Global Risks* is a decision of the NSW Court of Appeal. It involved a material damage policy. The insured, a building contractor, had cover under a contract works policy for "all physical loss or damage to the property insured occurring during the period of insurance". It had a building contract which included construction of two crib walls. The relevant wall was completed by October 1999. Cover under the policy commenced on 31 December 1999. In February/March 2000, problems became manifest with the wall. The wall had to be rebuilt. Coverage under the policy depended in part on whether damage occurred before or after the policy inception.

[54] Mason P summarised the insurer's position in these terms:

> 39 The insurer accepted that this was an occurrence-based policy, but argued that the relevant occurrence happened in 1999, before the period of insurance. It submitted that the deficient collocation of building materials was itself physical damage.

He noted and rejected an alternative submission that physical damage in consequence of inadequate construction had actually occurred in 1999. He found no support for this contention, in that there was no proof of splitting or cracking before March 2000.

[55] Mason P summarised the insured's position as follows:

> 50 The insured accepts that the instant Policy responds when there is some injury to property (citing Graham Evans & Co v Vanguard Insurance Co Ltd (1987) 4 ANZ Ins Cas 60-772 at p74,693 per Dowsett J). It does not dispute that the eastern wall was defective when built. Its submission, however is that unless and until the defects manifested themselves in injury to the structure such as buckling, splitting or crushing there was no "physical damage to the property insured" within the meaning of the Policy. This occurred for the first time in about March 2000. I accept these submissions.

[56] Mason P's conclusion (with which the other members of the Court agreed) is summarised in paragraph 52:

> 52 The insurer did not suggest that the Policy would not have responded merely because the original work and materials were defective. But it submitted that the judge's findings went further, in establishing that the eastern wall was doomed from its inception. So much may be conceded, but there remains a critical distinction between property that is liable to become damaged and property that is damaged. The Policy did not respond until physical damage actually occurred. The Insuring Clause extended to physical loss or damage *"arising from any cause whatsoever"*. It cannot be rewritten merely because of the absence of an exclusion clause broad enough to cover the sub-contractor's bad work and inadequate materials.

[57] I do not regard that case, in the light of those passages, as supporting a manifestation trigger in preference to an injury-in-fact trigger. At paragraph 52, the statement is made that the policy did not respond until physical damage had actually occurred. There is no reference in that paragraph to a need for the physical damage to have become manifest. The description of the insurer's contention at paragraph 39 makes it clear that it did not contend that the damage which became manifest in 2000 had occurred earlier and remained latent. Rather, the contention was that the deficient collocation of building materials was itself physical damage. That proposition was rejected, as was the proposition that there was in fact damage in 1999. I do not think that the reference in paragraph 50 to the defects manifesting themselves in injury to the structure is, on the facts of that case, intended to draw a distinction between the occurrence of the damage and its manifestation. The problems (described at paragraph 15 of the judgment) were that several timber elements in the crib wall were broken or not adequately bearing on headers. That

would not have been a latent problem. The point is specifically addressed in these terms:

> [40] The factual issue, raised in the alternative, was the submission that physical damage in consequence of inadequate construction had actually occurred in 1999. In my view, there is no support for this alternative contention. There was no proof of splitting or cracking before March 2000. ...

[58] The case is accordingly not one of latent damage which had occurred but not become manifest. It therefore does not support the application of a manifestation trigger in preference to an injury-in-fact trigger.

[59] *Bolton* was concerned with liability insurance in respect of a construction worker who died from mesothelioma diagnosed in 1991 as a result of inhaling asbestos on the insured's building site between 1960 and 1963. The insured sought to recover the damages paid from MMI, the public liability insurers on risk from 1980, when the insured contended that the mesothelioma occurred. The MMI policy covered the insured's liability for "accidental bodily injury or illness ... when such injury or illness ... occurs during the currency of the policy." MMI contended that the relevant insurance which should respond was that in force when the worker was exposed to inhalation of asbestos dust. The Court of Appeal rejected the proposition that the inhalation of the asbestos fibres by itself constitutes accidental injury under the policy. It held that actionable injury does not occur on exposure or on initial bodily changes happening at that time but only at a much later date. The Court did not need to resolve whether that later date was when a malignant tumour was first created or when identifiable symptoms first occurred, because MMI was on risk throughout the relevant period.

[60] The finding in *Bolton* that exposure to asbestos was not injury means that *Bolton* is of little assistance in the present context in choosing between injury-in-fact and manifestation. That choice would be relevant on the question which was left open, namely whether the relevant trigger point is when a malignant tumour is first created (latent damage) or when identifiable symptoms first occur (manifestation).

[61] *Bolton* has been extensively discussed in a subsequent judgment of the High Court in *Durham v BAI (Run Off) Ltd* [2009] 2 All ER 26. That was concerned with the appropriate trigger for cover for mesothelioma under an employer's liability policy. It was not referred to by counsel before me. It deals with employer's liability policies, and the judgment expressly noted that different considerations apply to such policies. I mention it only for completeness, and do not discuss it.

[62] *Allstate Insurance v Axa Pacific Insurance* is a decision of the Supreme Court of British Colombia. Allstate and Axa had each issued public liability policies, for different periods, to an insured company which had performed work on the roof of a warehouse. Work was substantially completed by May 1989. After completion, rain leaked through the roof, and despite attempts at remediation continued to leak until October 1992. The insurance coverage was with Allstate to October 1990 and with Axa from then on. The insured's liability was for damage to goods stored in the building. The damage happened at various times from May 1989 to October 1992. The particular issue before the Court was liability for defence costs. Pitfield J described the issue in these terms (at paragraph 20):

> The issue for decision is whether Axa had a duty to defend [the insured] because inventory or property was damaged in the period covered by its policy although the leak in the roof, which was the condition creating the opportunity for the water to pass through the roof, arose solely during the Allstate policy term.

[63] The Judge noted that the parties had regarded the case as a test case inviting a general consideration of "trigger theory" in relation to comprehensive general insurance policies. He said (at paragraph 29):

> The Axa policy is not ambiguous on its face. In the context of this case the risk insured is bodily injury, personal injury, and injury to or destruction of property "during the period of coverage". The criteria selected by the insurer and agreed to by the insured is injury in fact during the term of the policy.

He said (at paragraph 39):

> The water damage to any item of inventory did not occur over time. The damage occurred when the water dropped on the item of inventory during any particular rainstorm. Damage occurred at the instant. It did not progress through a succession of events.

That case too was not concerned with latent damage, or continuing damage. It provides little assistance in the context of this case, where the damage is both latent and continuing.

[64] *Dow Chemical Company v Associated Indemnity Corporation* is a decision of a United States District Court. *Dow* had developed a mortar additive, for use in the construction industry, which caused rusting of the steel within the mortar. Issues as to liability among various insurers of Dow arose. The Court noted that there may be several stages of undesirable physical change within the walls of a building prior to manifested property damage. Several possible trigger theories were described: manifestation, injury-in-fact, exposure and continuous or multiple trigger. The Court said (at paragraph 479):

> In reality, reference to trigger theories is more useful in describing what has been decided than in determining what the decision should be in a given case. The Court can discern no consistent pattern in the myriad trigger cases that prescribe the specific trigger theory to apply in a specific type of case. Furthermore, reference to trigger theories can be deceiving. Comparison of the manifestation theory with the injury in fact theory is absolutely meaningless unless there is some real possibility of a substantial time lag between the actual injury and the resulting manifestation.
>
> ...
>
> Moreover in all of these scenarios, "real" or "actual" injury must be defined in temporal relation to initial exposure or ultimate manifestation.
>
> ...
>
> Consequently, trigger rulings are most appropriately derived by reference to the operative policy language, as opposed to the judicial gloss placed upon similar language is ostensibly analogous cases.

The Court summarised its ruling in these terms (at p 487):

> The Court's ruling constitutes a rejection of the exposure and manifestation theories, and an adoption of the injury in fact trigger theory. The contract language is clear on this point, and the case law generally supports the Court's chosen approach.

[65] *Maryland Casualty v W R Grace and Co* is a decision of the US Court of Appeals, Second Circuit. It involved a former manufacturer of asbestos products and its insurers. The issue was when damage occurred to a building in which asbestos had been installed. The lower Court had denied coverage on the basis that under

New York law the discovery of damage must occur during the policy period. The appeal was allowed. The Court said (at paragraph 12):

> We think that property damage insurance should be treated the same as insurance for bodily injury, which under New York law is governed by an "injury-in-fact" trigger. The relevant language in the insurance policies supports a damage in fact trigger for property damage claims. From adopting such a damage-in-fact trigger, it follows that insurers are obligated on the risk undertaken when asbestos was installed in the buildings involved in the underlying lawsuits against Grace.

(d) Discussion as to the trigger point

[66] One principle emerges clearly from that review of the authorities. That is that the search for a trigger for coverage under a public liability policy must be firmly grounded in the policy wording. I consider that the wording of this policy is plain: what is covered is damage happening during the policy period, not damage becoming manifest during the policy period. Where damage has occurred but is latent, there is nothing in the wording of the policy to suggest that coverage depends on the discovery of the damage rather than the happening of the damage.

[67] Counsel for Arrow submits that the policy should be interpreted as requiring that the damage becomes manifest to avoid what counsel submits would otherwise be an absurd result. He submitted in opening:

> [16] If the position were not as set out above, an absurd result could ensure. In all cases of latent damage, an insurer would be able to contend that, from an applied biology or chemistry perspective, damage had already occurred before anyone was aware of it. This reasoning would be applicable to latent damage affecting timber, concrete or steel, or involving common problems such as subsidence or cracking. It would mean that a prior insurer might be liable even though there was no occasion or opportunity to notify that insurer of circumstances that may give rise to a claim.

[68] I do not consider that the interpretation which I adopt does produce an absurd result. The fact that an insurer may be liable even though there was no prior opportunity to notify the insurer of a claim is a common outcome under an "occurrence" liability policy. An occurrence policy provides cover for an insurer's liability to pay damages consequent upon damage resulting from an occurrence within the policy period. That is to say, the triggering event is the occurrence, not

the damage resulting from it. With such policies, it is quite common for damage to occur many years later. That is no barrier to the insured making a claim. The cover has been triggered by the occurrence during the policy period. The present policy is different, in that it is the damage, rather than the occurrence from which that damage results, that must happen within the policy period. The damage, rather than the occurrence, triggers the cover. The practical implications of the time lag between the happening of damage and its manifestation are not materially different from those of the time lag between the happening of an occurrence and the happening of damage resulting from that occurrence.

[69] There is one respect in which a manifestation trigger for this policy would produce a potentially unfavourable result for an insured. One important commercial distinction between an "occurrence" policy and a "claims-made" policy is that an occurrence policy creates a closer temporal connection between the conduct of the business by which the insured is exposed to potential liability and liability insurance coverage. That is so because the insured will be covered, after the business has ceased, for liability arising from occurrences when the business was carried on. Cover need be maintained only while the business continues. A claims-made policy, in contrast, may separate, often by many years, the time at which the business is conducted and the time when insurance cover for claims resulting from that business must be in place. That is because cover is triggered not by the occurrence out of which the liability arises, but by the making of a claim against the insured in respect of that liability. That means that an insured must maintain liability cover on a claims made basis long after the business has ceased. There is a forthright criticism of such policies in the construction industry in Hudson's Building and Engineering Contracts, 11th Edn, at 15.035 to 15.037. If a manifestation trigger were applied to this policy, that would have an effect, similar to that in a claims made policy, of separating, further than an injury-in-fact trigger would do, the business occurrence and the insurance cover.

[70] One consideration which might be regarded as relevant in deciding whether the trigger in a public liability policy in a latent damage case is injury-in-fact or manifestation is the nature of the cover provided by the policy. The cover is not for the property damage itself, but for the insured's legal liability to pay damages

resulting from the property damage. It might therefore be considered that that should favour an interpretation by which liability under the policy is triggered by the same circumstance as triggers the insured's legal liability to the claimant. See, for example, *Bolton* at paragraph [15].

[71] I think it questionable whether any, or any significant, weight should be given to that consideration. To the extent that it is entitled to weight, I regard it as supporting an injury-in-fact trigger. A cause of action in tort will generally arise when damage is suffered, rather than when it becomes manifest. That proposition is subject to some qualification in respect of the time at which a limitation period will begin to run. It is not appropriate to examine that issue in detail here. It is sufficient to note that the circumstances in which a claim in tort for damages based on physical damage to property (as distinct from economic loss, such as a diminution in value of damaged property) will be deferred because the damage is latent are limited. The general rule is that a cause of action will accrue on the occurrence of damage rather than on its manifestation: *Murray v Morel & Co Ltd* [2007] 3 NZLR 721 (SC) per Tipping J at [64].

[72] I do not think that considerations of certainty favour one trigger over another in the case of latent damage. Difficult cases will arise, on the facts, whichever of an injury-in-fact or a manifestation trigger is adopted. The date of occurrence and the date of manifestation (or reasonable discoverability) may be equally difficult to determine.

[73] Counsel for Arrow submits that a *contra proferentem* approach to the interpretation of the policy should be adopted, against QBE, and that, so interpreted, a manifestation trigger is appropriate. I do not consider that a *contra proferentem* interpretation should be adopted, broadly for three reasons. First, the *contra proferentem* principle may be invoked as an aid to resolving an ambiguity in the interpretation of a contract. I do not consider that the wording of this policy is ambiguous. Its plain meaning is clear, as I have held. Second, the principle is usually applied to the interpretation of clauses which exclude or limit liability: clauses which clearly favour one party. The provision in issue here is not of that sort. A manifestation interpretation would favour the insured in this case, but not

necessarily in other cases. A manifestation or an injury-in-fact interpretation is capable, in any particular case, of favouring insurer or insured, depending upon the timing of events in relation to insurance cover periods. This is a standard policy wording and its interpretation must be uniform. Third, as to counsel for Arrow's submission that a *contra proferentem* approach is appropriate because the policy wording was proffered by QBE, I note that that is disputed. There is evidence that the wording was based on a broker's wording. Because I consider that a *contra proferentem* approach is not appropriate for the other reasons I have given, I need not discuss the evidence on that point.

When did the damage happen?

[74] I have held that the policy covers damage happening, not damage becoming manifest, during the policy period. I have also held that it is necessary to identify a single point in time which that damage occurred, despite the fact that the damage occurs progressively. That necessarily means that a single point of happening of damage must be determined, on what is, on the facts here, a continuum from the first incidence of fungal or microbiological attack on the timber to structural failure of the timber and whatever it supports. I first consider the authorities, and then apply those to the facts.

(a) The authorities

[75] The meaning of the term "damage" in an insurance context has been considered in a number of cases. Mr Ring describes as the leading authority the decision of the Supreme Court of Tasmania in *Ranicar v Fridgmobile Pty Ltd* [1983] Tas R 113. There, a consignment of frozen scallops had been rejected as the temperature had risen above the limit allowed for export while in the custody of a carrier. As a result the scallops could only be sold on the local market, for less than the contract price from the overseas buyer. The issue was whether the increase in temperature was "damage" to the scallops within the meaning of an exclusion clause in the contract of carriage, and the policy of insurance. Green CJ referred to the Oxford English dictionary definition of the word "damage" as "injury, harm; esp.

physical injury to a thing, such as impairs its value or usefulness". He felt unable to adopt that definition without qualification because the use of the word "injury" largely begged the question which he had to determine. He said:

> In my view, the ordinary meaning, and therefore the meaning which I should *prima facie* give to the phrase "damage to" when used in relation to goods, is a physical alteration or change, not necessarily permanent or irrepairable, 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 will depend upon the nature of the goods.

Applying that definition, he held that the scallops had suffered damage.

[76] In *Cedenco Foods Ltd v State Insurance* Ltd [1997] 6 NZBLC 102,220 a tomato crop had been insured under a policy which covered damage resulting from excessive rain fall. The insured was unable to plant some seedlings which had to be dumped. Salmon J held that the seedlings had suffered damage, but the damage was not causative of the plaintiff's loss. He referred to *Ranicar* and said (at 102,227):

> It seems clear from the cases that in considering whether damage has occurred the test is whether there has occurred an alteration to the physical state of the goods which impairs their value or usefulness. In so far as the tomato seedlings were no longer suitable for planting out, it is clear to me that their value or usefulness was impaired and they were therefore "damaged".

[77] Counsel for QBE also refers to *Quorum A S v Schramm* [2001] EWHC 494. A pastel painted by Degas was stored in a warehouse which suffered a fire. The pastel was insured under a policy which covered "direct physical damage". Thomas J held that the paper had been damaged by the heat and humidity and the cooling, and that there was sub-molecular damage to the pastel itself with resultant greater fragility of the pigment and a possible lack of adhesion. There had been a loss of brilliance detectable only to the highly expert eye and not discernible by an experienced collector who would be the most likely purchaser. Thomas J addressed the submission by underwriters that those matters did not constitute direct physical damage in these terms:

> I do not agree with that submission on the facts of this case as I have found them to be. I accept that depreciation in value because of the suspicion of possible physical damage is not covered; I also accept that indirect physical

> damage is not covered. However, I have found that there was sub molecular damage to the pastel caused by 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 its effects on the pastel. That conclusion is supported by a decision of a Tasmanian court in *Ranicar v Fridge Mobile Pty Ltd* [1983] Tasmanian Reports 113.

(b) Application to the facts

[78] Applying the definition of damage from the authorities to which I have referred, the question is when has there occurred an alteration to the physical state of the timber which impairs its value or usefulness as a component in the building. In considering that question, the word 'physical" both as it is used in the authorities, and as it is used in the operative clause of this policy, is to be understood in its ordinary sense of "of or relating to things perceived through the senses as opposed to the mind; tangible or concrete" rather than in its more technical scientific sense of relating to physics rather than to other branches of science. That is to say, the use of the adjective "physical" in conjunction with "damage" is not intended to exclude tangible damage which is biological or microbiological in origin.

[79] At one end of the spectrum of potential trigger points is the stage where the process of decay has reached a point where a structural failure in some component of the building occurs. In determining whether that is the appropriate trigger point in terms of this policy, I consider that it must be borne in mind that this is a liability policy. The insured's liability to the building owner will arise well before that point has been reached. The building owner will have suffered damage, as a matter of law, from the rotting of the timber before that rotting has advanced to a point where structural failure of the timber to perform its function in the building occurs. In this case, damage has clearly been suffered by the building owners before structural failure has occurred. A large part of the damages paid under the settlement related to the cost of remedial work necessary to replace rotting timber, where no structural failure had yet occurred. To adopt, as the appropriate trigger point for policy coverage, a point where structural failure occurs would mean that the insured may not be covered for its liability in damages, where damages fall to be assessed prior to structural failure.

[80] At the other end of the spectrum is the point where fungal or microbiological infestation first occurs. On the evidence, that point will be not earlier than the time at which moisture saturation of the timber has reached a level where conditions favourable to colonisation have arisen. The "physical damage" to which this policy refers is not the inadequate building work which permitted the entry of water to saturate the timber. That distinction was clearly made in *Axa Global Risks* at paragraph [52] (set out at paragraph [56] above). Similarly, in this case, the fact that water ingress was inevitable, and that fungal infestation and decay of the timber was also inevitable, does not mean that damage in terms of the policy occurred at the time of construction. Also, the evidence does not indicate that the wetting of the timber *per se* constitutes a physical change which impairs its value.

[81] Counsel for Arrow submits that an approach which treats the colonisation by fungi as the damage which triggers liability under the operative clause in the policy would lead to uncertainty as to the point at which the colonisation has reached a level where damage can be said to have occurred. He submits that certainty would be better achieved by fixing a point at which there is some observable physical manifestation.

[82] I have earlier rejected the proposition that it is manifestation of latent damage which is the trigger point. In that context, the latency, or non-manifestation, which was relevant was that the timber itself was covered up by other building components and so the fungal damage was not observable. One possible point of damage is when there is some physical manifestation of fungal colonisation which would have been apparent if the timber had been inspected. Another possible point of damage is the point at which the fungi begin to break down the structural components of the wood cells. I consider that each case must be examined on its own facts to determine when an alteration to the physical state has occurred to an extent which is more than *de minimis* so that the point has been reached where physical damage has happened.

[83] It is not necessary in this case to determine that point with precision. The question is whether that occurred before or after 30 May 2002. On the evidence, I am satisfied that it had occurred well before that date. The evidence of Dr Wakeling and Dr Spiers satisfies me that the timber must have reached a stage prior to that date

where the physical state of the timber had been altered to an extent which impaired its value and usefulness. I have summarised their evidence on this issue at paragraphs [28] to [31]. Even if the extent of the decay and loss of strength was within the lower range given by Dr Wakeling, I consider that it had reached a stage where physical damage had occurred. That extent of physical damage would clearly have been sufficient to constitute damage giving rise to a cause of action in tort. That conclusion makes it unnecessary for me to make any specific finding on when moisture saturation point is likely to have been reached. I have summarised the evidence of Mr Wutzler and Mr Hazlehurst on this issue at paragraph [36]. I consider, on the balance of probabilities, that water ingress is likely to have occurred in at least some locations quite soon after construction. I consider it probable that moisture saturation point would have been reached, in at least a significant number of locations, three to six months after construction. That is the range of estimates for that phase given by Dr Wakeling and Dr Spiers.

[84] It is relevant in this regard to consider the effect of the physical damage in relation to the cost of repair. I have summarised at paragraph [37] the evidence of Mr Wutzler and Mr Hazlehurst on this issue. In the light of that evidence, I find that, on the balance of probabilities, the stage which damage to the timber had reached by 30 May 2002 is such that, had the damage been observed in any part of the building, as it was later observed at unit 204, the only practical means of repairing the damage would have been to open up all areas where exposure of the timber to moisture was likely to have occurred, and to replace the affected timber. That would have entailed a scope of works broadly similar to that in fact held to be necessary when the value of the remedial work was later assessed.

[85] I find on the evidence, that the fungal or microbial damage such as to cause an alteration of the physical state of the timber to an extent which impaired its value and usefulness had occurred before 30 May 2002.

Conclusion as to coverage

[86] For these reasons, I find that the physical damage to property consequent upon which Arrow's legal liability to pay the settlement sum arose occurred prior to

the inception of the policy on 30 May 2002. That conclusion means that there is no cover under the operative clause in respect of this claim. Arrow's claim must fail.

The Defective Products Exclusion

[87] I deal only briefly with the remaining issues, since all of them are dependent on the success of Arrow's contention that cover is available. The next question, if I had concluded that there was cover under the operative clause, would be whether any part of the claim is excluded by reason of the defective products exclusion set out in paragraph [5]. The essential question, on that issue, is whether the apartment complex of Luxford Villas is a "product". Arrow contends that it is not. It submits that if there is any genuine ambiguity in the language of the defective products exclusion and the related definition of products in the policy, that should be resolved against QBE. It submits that the intention of the parties in relation to the scope and effect of the defective products exclusion is clear from the conduct of the parties and from other documents, which it says are inconsistent with the construction for which QBE now contends.

[88] The conduct and documents relied upon are as follows:

(a) Until 30 May 2004, the policy did not contain any express exclusion in respect of Arrow's liability consequent upon damage arising out of building defects, and that the exclusion for building defects set out in paragraph [6] above was included only after the claim was lodged, and in respect of the period of insurance from 30 May 2004.

(b) In May 2003 Arrow submitted a proposal to QBE for renewal on a QBE proposal form, and in that proposal, relating to products liability, it was stated that "Products Liability includes any goods manufactured, constructed, erected, installed, repaired, serviced, treated, sold, supplied or distributed by you";

(c) That Arrow did not complete any part of that section of the proposal and left blank the boxes requiring specification by the insured of any products sold, exported, or produced by it;

(d) That it may be inferred that Arrow did not deal in products within the meaning of the policy that it had no need for products liability cover and that both parties acted on that basis.

[89] I consider that a building comes within the definition of the word "product" in the policy, set in paragraph [4] above. The word "property" is not on its ordinary meaning limited to goods. It can include a building. Counsel for Arrow places some reliance on the reference to a container as pointing to the conclusion that a building is not property within the meaning of that provision. I do not agree. Clearly some forms of property may have a container. Equally clearly, others may not. I do not discern any intention to limit the term "property" to property which is or may be placed within a container of some kind.

[90] The other matters relied upon by Arrow in support of the contention that the defective products exclusion does not apply to a building all depend, to some extent, on the subsequent conduct of the parties as an aid to interpretation. The law may not yet be fully settled to the effect that subsequent conduct may be admissible as an aid to interpretation: *Gibbons Holdings Limited v Wholesale Distributors Limited* [2008] 1 NZLR 277 (SC). If such conduct is admissible, its probative value is a matter for assessment by the Court. It will ordinarily be relevant only for confirmatory or supporting purposes or as a cross check or reassurance that the meaning a Court is leaning towards was that intended by the parties.

[91] When the evidence is viewed in that way, I do not consider that it demonstrates a settled intention to attribute to the defective products exclusion a meaning different from that which I have held to arise on the ordinary meaning of the words. I find the way in which products liability was dealt with in the 2003 proposal to be of little assistance in attributing to the parties a common intention that the defective products exclusion in the 2002/03 and later policies should not extend to buildings. The reference in the proposal form is to "Product Liability", not a

definition of "products". It does not, in my view, support the proposition that the parties have intended to attribute to the term "products" a meaning different from that specifically defined in the policy.

[92] Accordingly, had I held that the operative clause of the policy covered this claim, I would have concluded that the defective products exclusion applied, so as to exclude liability for the cost of repairing or replacing the defects.

Quantum

(a) Apportionment of the settlement sum

[93] Had I concluded that there was cover under the operative clause, but the defective products exclusion applied, it would have been necessary to deal with the apportionment question set out in paragraph [20] above. Again, I deal with that only briefly. The first point is whether the amount paid by Arrow under the settlement falls within the scope of the phrase "all sums that [Arrow] becomes legally liable to pay by way of compensation". Arrow relies, on this point, on *Enterprise Oil Limited v Strand Insurance Co. Limited* [2006] 1 Lloyds Rep. 500. Counsel for QBE points to *Lumberman Mutual Casualty Co. v Bovis Lend Lease Ltd* [1995] 1 Lloyds Rep. 494, which is to the contrary. However, counsel for QBE notes that that decision was not followed in *Enterprise Oil* and does not in this Court seek to rely upon it. I proceed on the basis that the fact that Arrow's liability was resolved by settlement rather than by judgment of the Court does not deprive Arrow of any entitlement it may have to recover under the policy.

[94] However, because the settlement was for a global sum, and not for particular heads of damage quantified by the Court, an apportionment to exclude the cost of repairing or replacing the defective product would be necessary. Again, I deal only briefly with what is, for the reasons I have expressed, a hypothetical question. I have set out the respective contentions of the parties at paragraph [20]. I consider that it would be appropriate to have regard to the settlement negotiations in determining what part should properly be attributed to repair costs. Mr Bruce was the person

responsible, within Arrow, for dealing with the claim. He had authority to settle at mediation and made the decision on behalf of Arrow to settle at the second mediation. I am satisfied, on the basis of his evidence, including the cross-examination of him on a number of documents which were prepared as part of the settlement negotiation process, that the items for exemplary damages and stigma damages were, in practical terms, discounted in reaching the settlement figure. Mr Bruces' evidence is that they were still on the table and had not been withdrawn. I accept that, if settlement had not been achieved, those items would have formed part of the plaintiffs' claim at trial. However, the plaintiffs' assessment of the prospects of success on those items is likely to have been significantly lower than their prospects of success on the repair costs element of the claim. It would have been reasonable to expect that to be reflected in the settlement negotiations, and the documentary evidence suggests that, for settlement purposes, the plaintiffs did entirely discount those items. In those circumstances, it would be artificial to attribute any part of the settlement sum to either exemplary damages or stigma damages.

[95] Counsel for QBE presented a calculation based on excluding from the total settlement sum the claims for exemplary and stigma damages and some other items, and then apportioning the remaining items between repair costs (not payable by reason of the defective products exclusion) and other heads of damage (which the policy would cover). That would, on QBE's calculations, have given an insured proportion of approximately $700,000. It is unnecessary for me to consider the figures in detail.

(b) Costs

[96] The final quantum issue relates to defence costs. The agreement between the parties makes it unnecessary for me to address the apportionment of defence costs had I held that there was cover under the policy but defective products exclusion applied. My conclusion that the claim is not covered by the primary indemnity clause necessarily means that defence costs are not recoverable.

[97] The remaining costs issue which I should address briefly is the contention by QBE that defence costs were not incurred with the consent of the insurer. The position is that initial steps in the defect of the claim against Arrow were taken by the solicitor instructed by QBE. No question as to the payment of costs of those solicitors arises in these proceedings. QBE investigated the claim and stated its position on liability under the general liability policy in a letter dated 7 May 2007. At that stage, QBE accepted that some of the losses would be covered under the policy. It said however that the defective products exclusion would apply. It considered, having regard to the excesses payable for claims under the policy, that its exposure was small and it offered in full and final settlement a sum of $50,000. That offer was not accepted, so that it has no relevance except on the issue of consent to incurring costs. In an e-mail sent with that letter QBE said: "Please note that this is not an outright declinature. But, in view of the substantial uninsured losses I think it best that QBE bow out of the defence." Arrow took over the conduct of the defence from that point, without further communication.

[98] Because it is unnecessary for me to decide the point, I do not consider it appropriate to enter upon a detailed discussion. I would have found it difficult to accept that QBE's letter was not properly to be interpreted as indicating consent to Arrow incurring reasonable defence costs. Beyond that, it is not appropriate to comment.

Postscript

[99] When this judgment was already at an advanced stage of draft, counsel for Arrow submitted a memorandum dated 15 June 2009 addressing the English Court of Appeal decision in *Bolton*. Counsel for QBE responded by memorandum dated 17 June 2009, pointing out that *Bolton* had already been the subject of submissions by counsel for QBE. Nothing in those memoranda has caused me to make any changes to my draft reasoning, especially at paragraphs [59] to [61].

Result

[100] It follows from the foregoing that Arrow's claim must be dismissed and that there must be judgment for QBE against Arrow. Costs are reserved. The parties may submit memoranda if they are unable to agree.

"A D MacKenzie J"

Solicitors: Dawson Harford & Partners, Auckland, for Third Defendant
Hazelton Law, Wellington, for Seventh Third Party