

Is there damage to property if that property undergoes no physical alteration?

Most general insurance relates to property damage and what these words mean is often an issue in claim assessments. A Queensland case dealt with the meaning of property damage as the words arose in a product liability wording.

In the Austral Plywoods Pty Ltd case, Austral sold to a third party boat builder, marine ply with a high quality veneer, to be used in the internal fit-out of a yacht under construction.

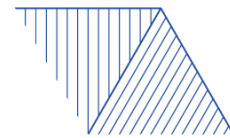
After the plywood had been incorporated into the construction of the boat, but before the boat was finished, its veneer began delaminating and, at considerable cost, all the plywood was removed and replaced. The person for whom the boat was being built sued Austral who in turn sought indemnity under their Broadform Liability policy, which provided indemnity for, amongst other things, Austral's liability to pay compensation for "property damage". These latter words were defined in the policy and the relevant part of that definition was – *"Physical injury to or destruction of tangible property ..."*.

At trial, the defendant insurer, who had refused indemnity, argued that there was no property damage as defined, only economic loss in that there was still a structurally sound boat, only one that now had diminished value due to the delaminated veneer. This notion was rejected by the judge who found there to be property damage but only to the plywood (which was undoubtedly damaged by the delaminated veneer), for which no indemnity could be granted by the operation of Exclusion 4, which excluded from cover – *"Property damage to the insured's products arising out of such products or any part of such products."*

But was the plywood the only property that was damaged?

On appeal, the Court said that to succeed, Austral had to prove physical injury to the boat's hull as that was the only other possible tangible property that could be physically injured, physical injury to the plywood itself being excepted from cover by Exclusion 4.

The Court found that the hull was physically injured. By screwing and gluing the plywood to the hull, together with the fact that the plywood proved defective, physical injury to the hull resulted. The determinant factor appears to be that the plywood was defective as, presumably, were it not, then the screwing and gluing alone would not amount to physical injury. The Court said:



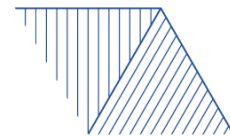
“Upon the permanent affixation of the defective plywood to the hull, the hull was not only physically injured by the screw holes and glue but was rendered unsuitable, or less suitable, for the purpose for which it was constructed.”

The quote indicates the real answer. Permanently attaching an Insured’s defective product to property that is otherwise unaltered by that permanent attachment, compromises the usefulness of that property and that amounts to physical injury and constitutes property damage. This helps to explain the difficulty many people experience with this problem, which is *“How can property that is not physically altered by the attachment to it of an insured’s defective product be said to be damaged?”*

The result of the case flows naturally from the above. The property that has been damaged is the hull and the measure of damage is the costs incurred in returning the hull to the condition it was in before the defective plywood was attached. This would amount to the costs of removing of the defective plywood and rendering the hull in a condition in which new plywood can be attached to it. But the costs of new plywood and attaching the new plywood would not be covered. In Austral’s case, both on appeal and at first instance, reference was made to the Canadian case of *Carwald Concrete & Gravel Co Ltd -v- General Security Insurance Co Of Canada*. Anyone who has an interest in this issue should take the trouble to read this case. P were to construct a concrete floor (called a “pad”) for a factory. Apart from the steel reinforcing bars, the concrete was to be poured over other apparatus needed for the operation of the finished factor. P contracted the supply and pouring of the concrete to C. C bought the cement for the concrete from H. The concrete failed to reach the specified compressive strength due to H’s cement being defective and had to be removed and replaced. This necessarily entailed the replacement of the reinforcement and the other apparatus now embedded in the defective concrete. A claim was made against C’s insurer. Conveniently, for our present purposes, the insuring clause of C’s policy is word-for-word the same as that in Austral’s case.

Carwald’s is, in one important way, a purer example of the problem than Austral’s. In the Austral case there was physical alteration to the hull of the boat as a result of the attachment of the defective plywood in the form of screw holes and glue. In Carwald’s case, the steel reinforcement and other apparatus were not physically altered in any inherent way by having the defective concrete poured around them. How can it then be said that there has been physical injury to that property if it has undergone no physical change?

One quote from the decision of the judge in Carwald is instructive:- *“In my opinion ... the pouring of defective concrete made the rebars, reinforcing*



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steel, ducting, wiring, plumbing and anchor bolts useless for the purpose for which they were installed as the pad could not be used, this constituted physical injury to tangible property.”

The conclusion is the same as in Austral, ie that the property to which the defective product was inextricably linked was rendered useless by the defect in the product. However, Carwald gives a better explanation and this comes from the words we have put in bold type in the above quote. Because the concrete, which was undoubtedly physically injured and, therefore, damaged property due to the defect in it, could not be used, that property to which it was inextricably connected could not be used and was damaged, although physically unaltered.

In Carwald, the Court was at pains to point out that their decision was based upon the fact that the pad was unusable, rather than on eof inferior quality only:- *“Supplying a defective product does not constitute damage to property merely because the product is not as valuable in the hands of the purchaser as it would have been if properly manufactured.”*

The Carwald policy also had an exclusion identical in all relevant respects to Exclusion 4 in the Austral policy, and the cost of the concrete itself was excluded from the claim.