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RAISE THE ROOF! COURT CONSIDERS POLICY COVERAGE FOR THE COSTS OF REMEDIATING SKY'S ROOF

The Court has recently handed down judgment in *Sky UK Ltd v Riverstone Managing Agency Ltd*[1] and others. This concerned a number of key issues under a Construction All Risks (CAR) policy.

Background

This matter relates to the construction in 2014-2015 of "Sky Central", the global headquarters of Sky in Hounslow, West London. This was a very large building said to have the largest timber flat roof in Europe at 16,000 square metres. The roof was created with glue laminated timber beams on top of which were placed 472 cassettes containing material to create a vapour control layer. The purpose of the cassettes was to prevent moist air from the building hitting the cold roof and forming condensation and mould.

Mace constructed the building on the basis of a (heavily amended) JCT Design and Build Contract 2011 dated 17 March 2014, and the design, supply and construction of the roof was sub-contracted.

Following installation of the cassettes it was necessary to permanently seal the roof externally with a Derbigum membrane. However, after the cassettes were put in place, and due in part to the method of installation, parts of them were left exposed to the weather for some time over the winter until they could be permanently sealed with the Derbigum.

No temporary roof structure was put in place to protect the work until the permanent weatherproofing was carried out. As a result, rainwater entered the cassettes after they had been placed on the roof. Some drying out works were attempted that were only partially successful and Practical Completion took place on 4 April 2015 without the issue having been resolved.

The issues

The claimants argued that the damage was caused by the failure to properly design the roofing works to include temporary protection, and that it was necessary to replace the roof like-for-like or with a less time-consuming scheme. The defendant insurers argued that their liability was confined to damage proved to have occurred during the period of the insurance policy, and that multiple deductibles or "retained liabilities" applied under the policy to the claimants' claims. Further, it was alleged that Sky was the only insured or the only one with a tenable claim. The cost of remediating the damage on the basis of the claimants' schemes was in excess of £100 million, whereas the defendants maintained that quantum would be in the region of £29 - £38 million.

Judgment

Judge Pelling KC gave judgment in this matter. We set out details of his findings on a number of key insurance issues below.

The Insurance Policy

The policy was entered into before the construction contract, but it was common ground that all of the parties were aware of the terms of the construction contract when the policy was underwritten, and that it should be considered part of the factual matrix.

[1] [2023] EWHC 1207 (Comm)

The policy consisted of a Policy Terms Document prepared by the brokers which incorporated parts of a Risk Details Document.

The period of insurance was 1 February 2015 – 15 July 2017.[2]

The indemnity provided was for "*physical loss or damage to Property Insured, occurring during the Period of Insurance, from any cause whatsoever…*"

The Property insured was defined as "*Permanent works, materials (including those supplied free to the Project by or on behalf of the Principal, provided the value is included in the Contract Works Sum Insured), temporary works, equipment, machinery, supplies, temporary buildings and the contents thereof, camps and the contents thereof and all other property used for or in connection with the Project*."

The Policy included Design Exclusion 5 (DE5) which provided an exclusion for:

"*(a) The cost necessary to replace repair or rectify any Property Insured which is defective in design plan specification materials or workmanship*

(b) Loss or damage to the Property Insured caused to enable replacement repair or rectification of such defective property

But should damage to the Property Insured (other than damage as defined in (b) above) result from such a defect this exclusion shall be limited to the costs of additional work resulting from and the additional costs of improvements to the original design plan specification materials or workmanship. For the purpose of this Contract of Insurance and not merely this Exclusion the Property Insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design plan specification materials or workmanship in the Property Insured or any part thereof."

The Judge noted that the reason for DE5 was that the purpose of the policy was to insure against physical loss or damage and not for defects in design, plans, specification, materials or workmanship – which would be left to be resolved by other means such as claims against the contractor or sub-contractors or consultants. The Judge held that the effect of DE5 was that if the Property Insured is defective in any of the ways defined in (a) the policy will not respond unless loss or damage to the defective Property is caused by that defect. Then the policy will respond but subject to a more limited exclusion from recoverability, which is the additional cost of work from and improvements to the original design plan specification materials or workmanship of the relevant defective insured property.

Was Mace an insured?

It was not disputed that Sky was the only contracting party to the insurance (in addition to underwriters), expressly defined as the Principal Insured, and Mace was a "third party insured", ie Mace was not a contractual party to the insurance but was an insured party.[3]

The Judge held that, in accordance with previous authority, the scope of cover that a third party insured enjoys depends on the intention of the parties. A third party can only be insured to the extent intended by the contractual insured and the insurer[4].

Following *Rugby Football Union v Clark Smith*[5] and other authorities in deciding the scope of cover available to a third party insured under a CAR policy, it is necessary to consider the scope of cover the contractual insured (ie Sky) had agreed to procure in its contract with the third party (ie Mace). Generally, the cover will not extend further, because that would not accord with what the parties intended would be provided. The relationship between those two parties is to be found in the contract between them. Further, the nature of the third party insured's *"rights"* and *"interests"* in the Property Insured must be something that is determined by the construction contract.

Applying this to the facts the Judge held that the construction contract provided that risk and possession of the roof structure passed to Sky on Practical Completion. Mace did not retain any relevant rights or interests after that time, other than to the extent it had continued liability in respect of work done prior to Practical Completion.

Therefore, any claim by Mace under the policy would be confined to loss and damage occurring before Practical Completion. Its proprietary and possessory interest ended at that time, and this was the intention of Sky, Mace and insurers, because the construction contract distinguished clearly between loss and damage before and after Practical Completion.

However, the Judge rejected insurers' submissions that Mace was only covered in respect of remedial work actually carried out prior to Practical Completion. Although the fundamental core of what had been agreed in the contract was that the parties would apply a self-contained compensatory risk management scheme to loss or damage due to

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[2] There was an initial period of insurance and a maintenance period, but for the purposes of this claim insurers were content not to distinguish.

[3] The Judge rejected submissions that there was any distinction to be made between named and un-named insureds that were not party to the contract.

[4] *National Oilwell v Davy Offshore Ltd*[1993] 2 Lloyd's Re 582

[5] [2022] EWHC 956 (TCC)

acts of Mace and its sub-contractors before Practical Completion, it did not bar cover in respect of work carried out after.

The Judge questioned the proportionality of having Mace as a party to the claim in this case, where it was making largely common cause with Sky in order to claim a more limited sub-set of the indemnity, and which must be paid to Sky under the policy terms in any event.

Period of Insurance

The claimants argued that the indemnity included loss and damage occurring after the period of insurance, as it extended to the period when the cause of damage is being ascertained; the period where remedial works are being designed approved and procured; and any damage that began in the period of insurance and developed thereafter.

The Judge rejected the claimants' arguments, on the basis of the House of Lords decision in *Wasa v Lexington* [2010] 1 AC 180. *Wasa* is a well-known reinsurance case that makes clear that the policy period is fundamental in English law, and in that case it was held that the reinsurance covered only damage to property occurring during the period of cover. The Judge therefore found in favour of insurers on this issue, namely that there would be no cover for damage occurring after the expiry of the period of insurance.

Meaning of damage

The Policy provided cover against *"physical loss or damage to Property occurring during the Period of Insurance"* and the question was what constituted damage.

The Judge held that for damage to have occurred there must usually have been a changed physical state, which was emphasized by the language used in the policy.

The Judge considered a number of prior cases on this issue including *The Orjula*[6], and *Pilkington v CGU Insurance*[7] holding that it is apparent that many of these cases showed only an application of the general principles to specific facts. The point from the authorities was that there must be a tangible physical change that has occurred to the property insured, irrespective of whether it is visible or not, that has impaired the commercial value of the property in the sense of rendering it less valuable or of less utility. This also drew support from the Basis of Settlement provision in this particular policy.

Applying this to the facts, insurers accepted that physical changes that materially impaired the functions of the cassettes including the provision of structural support, environmental integrity or insulation would constitute physical damage, as would changes that might impact on health or safety or the longevity of the cassette, subject to the physical damage having this effect occurring during the period of insurance.

The Judge also held that, due to the need for physical damage to have occurred, the insurers would only be liable for the costs of investigations insofar as they revealed physical damage (and not, as the claimants contended, for the costs of opening all the cassettes to see if there was damage).

Therefore, to sum up, Sky was able to recover the cost of repairing, reinstating or replacing that part of the insured property that suffered physical damage during the period of insurance, and Mace would be limited to recovering in respect of physical damage that had been suffered to the date of Practical Completion.

Aggregation

The Policy provided that the Insured had a "*Retained Liability*" (ie an excess/deductible) which for claims under DE5 was *"£150,000 any one event"*. (This contrasted with another section of the policy which provided for the retained liability to be *"each and every loss")*.

The Judge accepted that following *Axa v Field*[8] the word *"event"* has a usual meaning in insurance, namely something that happens at a particular time, a particular place and in a particular way. What may be an event must be considered in the contractual context, including the perils insured against, and must be scrutinised from the point of view of an informed observer placed in the position of the insured on the basis of the true facts as at that time[9]. The Judge noted that this policy contrasted *"event"* and *"loss",* and an event was something out of which a loss or series of losses arise[10].

The claimants argued that the single proximate cause of the damage was the failure to specify the need for or provide temporary roofing.

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[6] [1995] 2 Lloyd's Rep 395

[7] [2004] BLR 97

[8] [1996] 1 WLR 1026

[9] *Kuwait Airways Corporation v Kuwait Insurance Co*

[10] *Caudle v Sharp* [1995] Lloyd's Rep IR 433

The insurers argued that in law a decision cannot constitute an event or occurrence following *Midland Mainline v Commercial Union Assurance*[11], and the damage each cassette suffered was a separate event with a separate retained liability. Further, that the design decisions the claimants relied on were not material as the policy insured damage to property, and the damage was caused by the water ingress not the design.

However, the Judge rejected insurers' submissions and took into account the judgment of Butcher J in *Stonegate v MS Amlin*[12], which held that a decision could be an event or an occurrence in the context of COVID-19 Business interruption insurance. The Judge held that the true legal principle was that whether a decision was an event is a question of fact.

Therefore, the Judge held that in principle, if at least an effective cause of the damage was the decision not to take temporary waterproofing measures, that would satisfy the unities of time, place and cause.

Therefore, the damage would be subject to one single retained liability.

Factual and Quantum issues

Having determined these points of law, the Judge went on to consider the factual and quantum issues finding that a number of cassettes were damaged by the end of the policy period, due to the failure to use a temporary roof for protection.

With regard to quantum, the Judge accepted that quantum would be awarded based on a scheme put forward by insurers, which most closely approximated the damage recoverable and took account of the policy period and addressed damage that remained after 2018-2019 drying work, plus some specific additional costs. There were some particular issues of interest in relation to quantum. The insurers submitted that as the policy was a property insurance the costs of decanting staff to temporary accommodation or carrying out works out of ordinary business hours was irrecoverable as it was consequential loss (which was expressly excluded). The Judge rejected this argument. The policy responded to the full cost of remedying the damage and it ought reasonably to have been in the contemplation of the parties when entering into the policy that it may have to respond in relation to remediation taking place after Sky had occupied the building. This was not consequential loss (which would be concerned with loss of income or other business interruption).

The parties were directed to agree the relevant sum that gave effect to the Judge's conclusions or to identify what further findings were required.

Comments

The case turned on its own facts, but the Judge's comments on policy period, the meaning of damage and aggregation will be of interest to the market, particularly in light of the upcoming appeal in *Stonegate*. Particularly noteworthy is the finding that a "decision" can be an event for purposes of aggregation. It is also a useful reminder for policyholders that the burden is on them to prove what damage has occurred and they should make every effort to do so to avoid costly disputes on quantum. There is also a helpful reminder of the caselaw summarising what amounts to "damage".

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[11] [2004] EWCA Civ 1042

[12] [2002] EWHC 2548 (Comm) Note that *Stonegate* is currently under appeal.

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