

INSURANCE | JANUARY 2024 (AUSTRALIA)

# INSURANCE COVERAGE FOR 'PROPERTY DAMAGE' CAUSED BY AFFIXING COMBUSTIBLE CLADDING

*The Owners – Strata Plan No 91086 v Fairview Architectural Pty Ltd (No 3) [2023] FCA 814*

Courts have long grappled with the question of whether incorporating defective materials into property is 'property damage' for the purpose of an insurance policy. Helpfully for contractors and property owners, the Federal Court of Australia in *The Owners – Strata Plan No 91086 v Fairview Architectural Pty Ltd (No 3) [2023] FCA 814* held (albeit on an interlocutory basis) that in the circumstances of this case the affixing of combustible cladding onto buildings caused 'property damage' for the purposes of the relevant insurance policy. The decision is helpful for policyholders seeking coverage under property or liability insurance policies that are triggered by 'property damage' in circumstances where defective materials are incorporated into otherwise undamaged property.

## Background

Fairview Architectural Pty Ltd (**Fairview**) manufactured and supplied combustible Vitrabond panels that were affixed to two high-rise residential buildings in Warwick Farm, NSW. During the period when the panels were fixed to the building, AAI Limited (**AAI**) provided liability insurance coverage to Fairview. AAI's policies stipulated that Fairview would be covered for its liability to pay compensation in respect of 'Property damage' which was caused by an 'Occurrence'. 'Property damage' was defined as 'physical loss, destruction of or damage to tangible property.' 'Occurrence' was defined as 'an event....which results in....Property Damage....that is neither expected nor intended....from [the insured's] standpoint.'

The owners' corporation of the buildings (**Owners**) were ordered by their local council to remove the panels. The Owners brought a claim against Fairview and sought to join AAI to the proceeding (in circumstances where Fairview was in administration).

All parties agreed that the Vitrabond panels were defective and not of merchantable or acceptable quality per the *Trade Practice Act 1947* and the *Australian Consumer Law*.

The Federal Court considered, on an interlocutory basis for the purpose of considering the application to join AAI, whether it was at least arguable that AAI's policies responded to Fairview's claim.

To resolve this issue, the Federal Court considered whether:

1. Fairview's potential liability arose from 'property damage' (physical loss, destruction or damage to tangible property); and
2. The property damage was caused by an 'occurrence' (an event which results in property damage that is neither expected nor intended).

## Relevant authorities

Justice Wigney of the Federal Court considered several relevant authorities concerning whether 'property damage' for the purpose of an insurance policy was caused by the incorporation of defective materials into otherwise undamaged property.

## Austral Plywoods

In *Austral Plywoods*<sup>1</sup>, the insured supplied plywood to a boat builder who affixed the plywood to the hull of a boat using screws and glue. The plywood was defective and had to be removed. The glue also had to be removed and the screw holes filled. The insured's policy covered liability to pay compensation for "*property damage caused by an occurrence in connection with the insured's business*".

The Queensland Court of Appeal determined that physical damage to the hull occurred at the time the plywood was affixed to the hull of the boat, rather than at the time of removal. The Court held that that insurance policy covered the insured party for its liability to pay for the cost of removal of the defective plywood and the restoration of the hull to a state in which new plywood could be affixed.

## R & B Directional Drilling

In *R & B Directional Drilling*<sup>2</sup>, the insured party was contracted to construct a tunnel for a cable crossing. During the grouting process, concrete entered one of the conduit pipes within the tunnel rendering it useless to carry a cable. The grouting and conduit pipes were required to be removed from the tunnel. The insured party's policy covered liability to pay for compensation in respect of physical injury to or loss of or destruction of tangible property.

The Federal Court of Australia held that there was no physical injury to the tunnel. The Court found that the defective work could be removed which would leave the tunnel in the same physical state it was in before the defective work.

## Pilkington

In *Pilkington*<sup>3</sup>, the insured manufactured heat-soaked toughened glass panels which were installed in the roof and vertical panelling of the Waterloo Eurostar Terminal. A small number of the panels were defective, however the terminal owner chose not to remove the panels and instead installed safety features which prevented any fractured glass falling into the terminal. The insured made a claim under their insurance policy which covered physical loss to property.

The Court of Appeal (England and Wales) held that the insurance policy did not cover the costs of the remediation scheme as the installation of the panels had not caused any physical damage to the building.

## The decision

Justice Wigney held that resolution of the question of whether coverage under the AAI policy was engaged was "not easy". However he held that the better view is that the affixation of the defective Vitrabond panels to the buildings caused 'physical damage to tangible property' during the period of insurance and was caused by an 'occurrence'.

This was because:

1. The affixation of the defective panels caused the buildings to be substantially and materially less suitable for their intended use for residential housing; and
2. The means by which the panels were affixed to the buildings caused physical damage to the building themselves in the form of nail or screw holes in the walls and holes in the sarking that covered the walls; and
3. The removal of the panels was likely to result in damage to at least some of the top hat subframe that is affixed to the walls of the buildings. The inevitable result was that the top hat structure would have to be removed from the buildings and disposed of, as a result of which there would be a need to remediate parts of the buildings.

Justice Wigney also held that the affixation of the cladding panels could be characterised as an 'occurrence' because the damage was not expected or intended by Fairview. This was because Fairview did not expect or intend the panels to be combustible or defective, nor expected to have to remove the panels from the building.

Justice Wigney ultimately held that the circumstances in this case were relevantly indistinguishable from *Austral Plywoods*. Conversely, the Court did not find *R & B Directional Drilling* and *Pilkington* to be applicable to this case because, respectively in these cases, the defective work did not cause any physical damage and safety measures were taken to avoid damage to the terminal.

Therefore, it was at least arguable that AAI's policies responded to Fairview's claim and AAI could be joined to the proceedings as the second respondent and held liable to pay costs.

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<sup>1</sup> *Austral Plywoods Pty Ltd v FAI General Insurance Company Ltd* (1992) 7 ANZ Insurance Cases 61-110; [1992] QCA 4.

<sup>2</sup> *R&B Directional Drilling Pty Ltd v CGU Insurance Ltd (No 2)* (2019) 369 ALR 137; [2019] FCA 458.

<sup>3</sup> *Pilkington United Kingdom Ltd v CGU Insurance Plc* [2005] All ER (Comm) 283; [2004] EWCA Civ 23.

## Key takeaways

Although this was an interlocutory decision, given that it contained a detailed consideration of the evidence and applicable authorities, it is likely to be highly persuasive. Contractors or property owners may rely on this decision when bringing claims under either property damage policies or liability policies triggered by liability for 'property damage' in circumstances where defective material has been incorporated into otherwise undamaged structures.

For more information, please contact the author of this alert



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