A tale of blocked pipes, fly tipping, acid, Degas and an alcoholic beverage.

delivered by

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In 1676 Isaac Newton wrote: *"If I have seen further, it is by standing on the shoulders of giants"*. Thus he attributed much of his success to the work of those that went before him.

I stand before you this morning somewhat in awe of those who have addressed this Association before me – great names such as Lowndes, Richards, Manley Hopkins, Lindley, MacArthur, Rudolf, Elmslie and many, many more. Because so much of our work concerns precedent and practice all Fellows of this Association stand on the shoulders of these giants.

Many of you will be aware that my practice involves both marine and energy claims. I therefore thought that it would be appropriate for me to address an issue which has been something of a running sore for many years in relation to energy claims and which has reared its head several times in the last year or so in relation to marine claims. It is an issue that is quite likely to become more important as the trend away from named perils and toward all risks coverage continues.

The issue is 'what constitutes physical damage'?

Offshore energy policies have traditionally provided protection in respect of all risks of physical loss of or damage to the insured property and for many years there has been debate as to whether or not such things as:

- a piece of angle iron left inside a pipeline, or
- a pipeline blocked by frozen or solidified product, or
- a molecular change in structural steelwork as a result of stress, or
- contaminated property,

constituted physical damage covered by an all risks policy. Coverage is, of course, also dependent upon whether or not such physical damage, if correctly identified as such, was the result of an insured peril. However, I do not propose to address that issue in any detail but, in relation to all risks at least, would refer you to the proceedings of this meeting in May 2003 and, in particular the admirable presentation by Prof. Howard Bennett.

So – what constitutes physical damage? An easy question you may think, but I would suggest that although many, in fact, probably the vast majority of instances of physical damage are clear cut, there are instances, such as those already mentioned, which sit on the dividing line.

The problem is that, in some instances, not even the elephant test can be applied – physical damage may not in every case be easily recognised. Take a blocked pipeline for example. A close visual external examination may well satisfy you that it is in perfect condition. However, does the fact that it is also perfectly useless for its intended purpose make any difference?

Let us begin, perhaps where one should always begin when considering the definition of words, with the dictionary. The first dictionary that I consulted defined "damage" thus:

damage – injury, harm

but the same dictionary defines injury:

> ***injury – harm, damage***

and harm:

> ***harm – damage, injury***

So much for the Little Gem Dictionary!

But the Oxford English Dictionary gives us a more useful definition:

> ***damage – injury, harm; especially physical injury to a thing such as impairs its value or usefulness.***

But this definition, which, as we shall see, has met with judicial approval, can easily be faulted. Consider a 1987 Vauxhall Cavalier involved in a minor altercation with the much loved Clapham omnibus - a wing is dented. I think that everyone would agree that a dent constitutes damage, but its existence would most probably not affect the value of such a vehicle nor would it affect its usefulness – it could continue on its journey quite safely. Now consider a pump which has been wrongly assembled. Its utility is affected – it cannot be used – and its value is also affected because it is useless, but is it injured?

If a dictionary definition does not settle the issue, what are we to do? Mr. Justice Pearson in his judgment in the case of *Lewis Emanuel & Son Ltd and* (that well known litigant) *Another v Hepburn [1960],* considering the interpretation of the phrase *"physical loss or damage or deterioration"* arising from a strike, suggested:

> *"What is the natural and ordinary meaning of those words; what mental picture do they at once bring to mind? It is a matter of impression, but, in the end, in my view, one must decide the question on these lines…."*

He then went on to consider the condition of fruit, for that was the subject-matter of the insurance, when it is deteriorated, damaged and lost. The judgment is possibly of most interest to us for the Judge's conclusion that the word *"physical"* qualified, not only *"loss"* but also *"damage"* and *"deterioration"* and thus what was covered was physical damage rather than economic damage. The differentiation between physical damage and economic loss is an issue to which I will return.

The fact that the ordinary use of words is important was underlined in the judgment in the case of *British Celanese Limited v A.H. Hunt (Capacitors) Limited [1969]* which contains the following: *"If A put sugar into the petrol tank of B's motor car with the result, through clogging of the fuel pipes, that the supply of petrol to the carburettor is cut off, <u>everyone would say</u>, if asked, that A had damaged B's motor car"*. Despite this clarity of thought, the issue of whether or not blockages constitute physical damage has exercised the minds of, not only lawyers and judges over the years, but also claims practitioners. I have been involved in two cases where this was a major area of dispute – both concerned blockages in offshore pipelines.

It seems to me that the blockage of a pipeline results in the loss of its functionality as, by definition, a pipe is a hollow structure used for the conveyance of a liquid or gas. It is the loss of this essential physical characteristic which impairs its utility and thus constitutes damage. However, in both instances it was contended that the pipeline concerned, although blocked, was not itself damaged because its physical structure was not affected and the cost of removing the blockage was merely an economic consequence of the blockage.

And yet I have found reference to, but not the report of, a 1865 case involving a gentleman named Fisher. It would seem that this gentleman was employed to operate an agricultural steam engine but had some altercation with his employer. Before he left he appears to have attempted to sabotage the engine by putting obstructions in its parts and similar but it seems that it only took a couple of hours and no materials to restore the engine to proper working order. In this case it was held that an obstruction temporarily rendering a machine useless for the purpose for which it was intended to be used can be damage. So clearly the impairment of the function or use of property can be a factor in determining whether or not that property is damaged.

The *British Celanese* case, referred to earlier, involved a claim arising from a power interruption that resulted in some machinery becoming clogged with solidified material that had to be cleaned out before that machinery could be used again. It was contended that the fact that the machinery had to be cleaned, did not evidence that the clogging of the machinery constituted an injury to property. The Judge disagreed and found that the clogging did constitute physical injury.

This decision was affirmed in the case of *S.C.M. (United Kingdom) Limited v W.J. Whittall & Son Limited [1971]* where it was held that the blockage of pipes with material that had solidified as a result of a power failure, constituted physical damage. The case concerned a claim against a contractor by whose negligence the power failure had occurred. The loss of power resulted in the loss of heating to molten materials in process. S.C.M. claimed the cost of clearing the blockages and the replacement of damaged parts, which were held to be physical damages, plus a claim for loss of production consequent upon such blockage.

So this line of cases supports the view that equipment that is prevented from working as a result of a blockage is physically damaged. But what of the wider issue of contamination where perhaps the contaminated property may still function.

I will commence consideration of this line of cases with a criminal case – *Regina v Henderson and Batley [1984]*. The case concerned a land site that had been cleared in preparation for building. Messrs Henderson and Batley, pretending to act with authority, operated the site as a public tip, being paid to allow the dumping of 30 lorry loads of soil, rubble and mud on the site. They were charged with the offence of the intentional or reckless damaging of a development land site. Part of their defence was that the land was not damaged and that there was a difference between the cost of putting something right and actual damage.

Unfortunately for them, the Court, whilst recognising a possible distinction between the cost of correction and damage, expressed the view that the fact that money was spent correcting the problem, was not determinant of whether or not the site was damaged – that was a

question of fact and degree. Mr Justice Cantley quoted the Concise Oxford Dictionary's definition of damage: *"injury impairing value or usefulness"* and went on to say:

> *"That is a definition that should fit in very well doing something to a cleared building site which at any rate for the time being impairs its usefulness as such. In addition, as it necessitates work and the expenditure of a large sum of money to restore it to its former state, it reduces its present value as a building site. This land was a perfectly good building site which did not need £2,000 spending on it in order to sell or use it as such until the appellants began their operations."*

Although a criminal case, *Regina v Henderson and Batley* was quoted with approval in the civil case of *The "ORJULA" [1995]*.

This case arose from the carriage of drums of hydrochloric acid and sodium hypochlorite shipped in two containers on the "ORJULA" from Felixstowe to Benghazi in Libya. Enroute the vessel was to call at Rotterdam to load further cargo. However, upon her arrival at the Hook of Holland pilot station, it was noted the container containing the acid was leaking. The vessel was ordered to a tank cleaning berth where the containers were removed and the vessel's contaminated deck and hatch covers decontaminated using soda and freshwater. An inspection indicated that the drums of chemicals had not been properly stowed within the containers.

The Bareboat Charterer of the vessel raised claims in contract or for negligence in tort against the shipper of the cargo, the supplier, freight forwarder and road haulier in the UK. One of the defences raised was that there could be no duty of care in relation to the contamination of the vessel as it did not amount to physical damage.

It was submitted by the defendant that, prior to the cleaning, the vessel was undamaged albeit with a layer of hydrochloric acid over part of her deck and hatch covers. Interestingly no submission was made that the underlying material of the deck and hatch cover had been altered in any way by the contamination. In his judgment, Mr Justice Manse, as he then was, after reviewing *Regina v Henderson and Batley* indicated that the test applied in a criminal case was relevant in a civil test also and said:

> *"Here, specialist contractors were engaged in undertaking the decontamination work using soda to neutralize the acid before washing the deck and hatch covers down with fresh water; further, it is pleaded, not perhaps surprisingly, that the vessel was required to be decontaminated of the hydrochloric acid before she could sail from the special berth to which she had been directed after discovery of the leakage. On these alleged facts, I would have no hesitation in concluding that the vessel should be regarded as having suffered damage by reason of her contamination."*

In 1995 the Court of Appeal heard the consolidated cases of *Hunter and Others v Canary Wharf Limited* and *Hunter and Others v London Docklands Development Corporation [1995]*. These actions concerned the law of nuisance. The first action concerned poor television reception in people's homes allegedly the result of the construction of the Canary Wharf Tower. This may be all very interesting but it is the second action that will concern us here.

This was a claim for damages in respect of damage to carpets, curtains and similar items caused by what were claimed to be excessive amounts of dust arising from the construction of the Limehouse Link Road. One of the issues before the court was whether or not the deposition of dust on property was capable of constituting actual physical damage to property which was necessary to found an action in negligence.

It was argued on behalf of the defendants, the LDDC, that no physical loss had been suffered, only economic loss in the form of extra cleaning costs. However, on behalf of the plaintiffs, all 600 of them, it was argued that: *"the deposit of dust … … amounts to damage in the ordinary sense of the word because it impairs the utility of the object onto which the dust is deposited"*.

In his Judgment, Lord Justice Pill said:

> *"In my judgment, the deposit of dust is capable of giving rise to an action in negligence. Whether it does depends on proof of physical damage and that depends on the evidence and the circumstances. Dust is an inevitable incident of urban life and the claim arises on the assumption that the Defendants have caused "excessive" deposits. Reasonable conduct and a reasonable amount of cleaning to limit the ill-effects of dust can be expected of householders. Subject to that, if, for example, in ordinary use the excessive deposit is trodden into the fabric of a carpet by householders in such a way as to lessen the value of the fabric, an action would lie. Similarly, if it follows from the effects of excessive dust on the fabric that professional cleaning of the fabric is reasonable required, the cost is actionable and if the fabric is diminished by the cleaning that would constitute damage. … … The damage is in the physical change which renders the article less useful or less valuable."*

However Lord Justice Pill went on to say:

> *"I agree with Lord Irvine* (Counsel for the Defendants) *that the fact it costs money or labour to remove a deposit of material on property does not necessarily involve a finding that the property has been damaged."*

This would seem to impact on our thinking following the other line of cases concerning contamination. However, I think that in the circumstances of this case, what was in the Judge's mind was that the removal of the dust, albeit in excessive quantities but not trodden in, would be a 'normal' operation just made more expensive. Contrast that with the removal of the acid from the deck of the "ORJULA" which, by no stretch of the imagination, could be regarded as a normal operation; it was a job carried out at a special berth by specialist contractors.

Another case dealing with the contamination issue was *Bacardi-Martini Beverages v Thomas Hardy Packaging Ltd. and Others [CA – 2002]*. It arose out of the production of Bacardi Breezers and Metz, both alcoholic beverages of the alco-pop variety. Thomas Hardy purchased CO2 from Messer UK Ltd, one of the Others, and combined this with alcoholic concentrate supplied by Bacardi and with demineralised water and certain other ingredients that they themselves supplied. Unfortunately, after the drinks had been manufactured and

distributed, it was discovered that the CO2 had been contaminated with very small amounts of benzene. This led to an expensive recall and the destruction of the product.

Both the Court of the first instance and the Court of Appeal differentiated between a product that had been damaged after manufacture and, as in this case, a product which was defective through its manufacture. It was held that there was no evidence that either the concentrate or the demineralised water had been affected by the introduction of the contaminated CO2 but that it was the usefulness of the finished product that had been affected. It was therefore held that there was no physical damage to property only the production of a defective product – the property simply did not exist before the ingredients were mixed together – *"The new product was not damaged, but merely defective from the moment of its creation"*. Any loss was therefore regarded as an economic loss rather than one arising from physical damage.

What distinguishes this case from the others concerning contamination, is that all of the others involve contamination, and therefore damage, to pre-existing property which was rendered useless or was depreciated in value until money was spent on it to restore it to its earlier condition.

You may have noted that none of these cases concern a dispute under an insurance policy, let alone a policy of marine insurance. However, it is not uncommon for words and phrases to be given the same meaning even when they are used in different contexts. For example, the test applied to determine whether or not a defect is latent was laid down in the case of *The "Dimitrios N. Rallias" [1922]*. Although the case concerned a dispute under a bill of lading, the test has been adopted for use in the context of marine insurance. I believe that it is clear that unless there is a definite reason to do otherwise, definitions of words and phrases approved in non-insurance contexts may well apply in an insurance context. So the fact that the legal guidance that we have examined in relation to contamination relates to criminal, civil and contractual matters does not necessarily debar them from providing guidance in relation to insurance claims.

Nevertheless, I do accept that one has to be cautious in this respect. One case that I intended to review in this address was that of *Blue Circle Industries Plc v Ministry of Defence [1998]*. This case arose from an escape of floodwaters from the Ministry's nuclear site onto Blue Circle's property that resulted in the latter becoming radioactively contaminated. Under the Nuclear Installations Act 1965 – Section 7 if anyone is interested – the operators of nuclear sites are under a duty to ensure that any waste from their site does not cause, inter alia, damage to property. Although the level of contamination was not such that it posed a threat to health or to the fabric of the property, it was above the levels permitted by statutory regulation and, for that reason, the Ministry was found responsible for cleaning the site. So what was relevant here was the meaning of physical damage within the context of the particular statutes, rather than by reference to ordinary meaning or legal precedent.

There is a further line of cases concerning damage and these relate to what we might call unseen or hidden damage.

There have been a number of instances when attempts have been made to argue that, as a result of an insured peril, materials have been stressed and have undergone some sort of molecular change that constituted physical damage. In most of the cases that I am aware of, it

was not possible to support this contention on anything other than a theoretical basis – there was no evidence of cracks or suchlike. So is there any legal support for such claims? Well yes, I think that there is.

The Australian, or rather the Tasmanian case of *Ranicar v Fridge Mobile Property Ltd [1983]* concerned a claim in respect of a consignment of shellfish which were found upon delivery to be at a temperature higher than that contracted. This had not, apparently, damaged the shellfish at all but had shortened their life expectancy. The court held that this reduction in life expectancy amounted to physical damage.

The other case, *Quorum A.S. v Schramm [2001]*, concerned a fine art insurance on the Degas pastel *"La Danse Grecque"*. The pastel had been insured in respect of: *"direct physical loss or direct physical damage of whatsoever nature…"*. During the period of the policy the pastel was stored in a strong room in a specialist warehouse the contents of which, outside the strong room, were destroyed by a fire. Although no smoke penetrated the strong room, it was agreed that, on the balance of probabilities, the pastel had been exposed to rapid changes in heat and humidity within the strong room as a result of the fire. Underwriters accepted liability for some paper tears and bowing of the board as direct physical damage caused by the fire. However, the assured also claimed that the pastel had suffered physical damage as a result of rapid changes to the environment within the strong room in terms of high levels of heat and humidity. There were also disputes as to the value of the pastel before and after the fire and whether or not the policy was a valued policy; but we are not concerned with these issues here.

Following the fire the pastel was examined by an expert who noted two tears in the paper which was partially detached from the backing board which itself was bowed and with evidence of recent mould. In the course of his evidence the expert said that he knew that the pastel had been damaged by being in the fire, but that it was very, very difficult to observe it.

The expert had made recommendations regarding restoration involving the repair of the tears, attachment to a new backing board and installation in a new frame with its own micro-environment; which work was duly carried out.

Further experts attested that as there was some uncertainty regarding the pastels' condition even after the restorative work and that there was some depreciation in the value of the pastel as a result of the fire. Experts in Paris stated that the picture superficially looked in a good state, but that it had been through severe stresses which had probably shortened its life considerably and it was impossible to give any guarantee for the duration of the effects of the restoration. Subsequently further restoration was deemed necessary and carried out.

Experts engaged by the parties for the purpose of the hearing agreed that there would have been molecular changes to the pastel as a result of the heat and humidity and also sub-molecular changes at a chemical level that were irreversible.

Mr Justice Thomas, accepted the evidence of the experts and found that:

> *"… there was sub-molecular damage to the pastel caused by the 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."*

The Judge cites *Ranicar v Fridge Mobile Property Ltd [1983]* in support of this decision.

I find this line of cases very interesting as it may well support claims for fatigue damage to vessels, mobile drilling rigs and offshore platforms if it is possible to demonstrate:

1. The operation of an insured peril,
2. Molecular change in materials,
3. Reduction in life expectancy, and
4. Consequent diminution in value.

Of all circumstances that I set out at the beginning of this address the one which is most troubling to me is that of the piece of angle iron left inside a pipeline. I can recall two claims of this nature that have succeeded. I believe that the basis for claiming was not that the presence of the angle iron constituted a variety of contamination but rather that because it prevented the pipeline from being pigged, a form of testing, its utility was affected. However, I think that the problem with this lies in whether or not the pipeline is injured.

If Mr Justice Pearson was right in saying in *Lewis Emanuel v Hepburn* that we should consider the natural and ordinary meaning of words, I think that it is open to argument that the presence of a piece of angle iron in a pipeline or a spanner left in the crankcase of an engine might not constitute physical damage because neither the pipeline nor the engine is injured in any ordinary sense of the word. But is the pipeline or the engine any less injured by the presence of the angle iron or spanner than a machine that cannot function because of solidified product in its passages? I would suggest that it is this loss of functionality or usefulness which is the key factor. If the presence of the iron or spanner is irrelevant to the proper working of the property, it would be difficult to argue that their presence constituted an injury, however, undesirable it might be.

There is a Canadian case almost on point. The coverage involved in *Canadian Equipment Sales & Service Co Ltd v Continental Insurance Co [1975]* was triggered by "injury" to property. It was held that the presence of a piece of pipe in a pipeline constituted an "injury" to the pipeline. The insured had negligently allowed the piece of pipe to fall into the pipeline, the presence of which could conceivable have resulted in a serious fire. It is this last factor which seems to have been critical to the decision.

So there we have it. A tale of damage in the form of blocked pipes, damage to a building site due to fly-tipping, damage as a result of contamination by acid, molecular damage to a Degas pastel but contamination to an alcoholic beverage constituting a defect rather than damage. But what does it tell us?

I think that it tells us that the following rules may be generally applied, albeit with caution and with due regard to the particular circumstances, in determining whether or not property has been physically damaged:

It must have suffered some injury which affects its

- Appearance (the dent in the old car), or
- Value, or
- Usefulness, or
- Life expectancy.

I think that on that note I should rest my case.

Michael D Harvey
May 2005