Case No 374/92.
E du Plooy

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

MCCARTHY CONTRACTORS (PTY) LIMITED Appellant

and

AEGIS INSURANCE COMPANY LIMITED Respondent

Coram: CORBETT CJ, VIVIER, NIENABER JJA NICHOLAS et HOWIE AJJA.

Heard:	Delivered:
8 November 1993.	1 December 1993.

J U D G M E N T

HOWIE AJA:

Appellant, a company carrying on business as a building contractor, sued the respondent insurance company in the Witwatersrand Local Division for payment in terms of a professional indemnity insurance policy. After the pleadings were closed the parties requested the Court below, in terms of Rule 33(4), to decide three questions of law separately from the other issues. The trial Judge (Cloete J) assumed an answer favourable to appellant on one question but answered the other, decisive questions in favour of respondent. He consequently dismissed the claim but granted leave to appeal to this Court.

For the purposes of deciding the questions raised the following facts were either agreed or assumed.

In August 1987 appellant contracted to perform certain construction work on an hotel in Somerset West.

This work ("the main contract") included the installation of an air-conditioning system. Later that month appellant engaged R & M Burrows Air-Conditioning (Proprietary) Limited ("Burrows") as a sub-contractor to install the system. In November 1987 Burrows and respondent entered into an insurance agreement pursuant to which the policy in question was issued.

In accordance with authorisation granted by respondent to a company referred to in the policy as "the underwriters", respondent undertook to provide Burrows with two forms of insurance cover. The material provisions of the policy in that regard (omitting presently irrelevant wording) read thus:

> "SECTION A - PROFESSIONAL LIABILITY.
> The Underwriters agree to indemnify the Insured .... for the sums which the Insured shall become legally liable to pay arising from any claim or claims first made against them during the Period of Insurance as a direct result of negligence in the performance of the Insured's Professional Activities as specified in the Schedule by or on behalf of the Insured in the course of the Insured's business.

SECTION B - DEFECT IN CONTRACT WORKS.

The Underwriters agree to indemnify the Insured .... for costs incurred in rectifying defects in the Insured's contract works or in the design plans or specification of such works.

PROVIDING

(a) The Insured can prove to the reasonable satisfaction of the Underwriters that the defect was the direct result of negligence in the performance of the Insured's Professional Activities by or on behalf of the Insured in the course of the Insured's business.

(b) Indemnity for the rectification of defects shall not extend to include the repair of damage to any other part of the contract works resulting from such defects."

In the schedule to the policy the insurance period was stated to be from 13 November 1987 to 12 November 1988 and the insured's professional activities were defined as meaning air-conditioning work undertaken by Burrows in its professional capacity. In addition, provision was made for what was called "the retroactive date" and this was 1 November 1985. The importance of that date was that in terms of an exclusionary clause in the policy the underwriters were not liable in respect of the performance of any of the insured's professional

activities prior to such date. Consequently, even if the sort of negligence referred to in the policy occurred prior to the insured period it could nonetheless lead to liability on the part of the underwriters if it occurred on or after the retroactive date.

As a result of negligence on its part which occurred between 1 November 1985 and 12 November 1988, Burrows failed to install the system in terms of the specifications of the main contract. Such negligence related to Burrows's defective design and installation of the system and constituted a breach of its professional duties in the conduct of its business activities.

Burrows did not renew the policy on expiry of the insurance period. It was later called on to rectify the defects but failed to do so.

On 21 February 1990 Burrows was provisionally liquidated and the provisional order was made final on 14 March 1990. Subsequently appellant itself incurred the cost of rectifying the defects and thereafter sued

respondent for reimbursement. Appellant relied on the terms of section B of the policy and claimed in Burrows's stead by invoking the substitutionary right of action afforded by s 156 of the Insolvency Act, 24 of 1936.

On the facts outlined, the questions for decision by the Court a quo were these:

1. Whether, on a proper construction of section B of the policy, respondent undertook to indemnify Burrows for the costs which a third party incurred in rectifying defects referred to in that section.
2. If so, whether respondent was obliged to indemnify Burrows if such costs were incurred after termination of the insurance period.
3. Depending on the answers to 1 and 2, whether the indemnity in section B was an indemnity within the meaning of s 156 of the Insolvency Act.

The trial Judge, having assumed an answer favourable to appellant on question 1, held, as regards question 2, that the costs referred to in section B had to be incurred during the period that the policy was in force. Consequently, because appellant's costs were incurred after that period had elapsed, respondent would

not have been liable to Burrows under the policy. That, in turn, meant, as regards question 3, that respondent was not liable to appellant under s 156 of the Insolvency Act.

To conclude this preliminary summary I may mention that for the purpose of reconsidering the three questions in issue, this Court was asked to take one further fact into account. It was agreed by counsel during the hearing of the appeal that Burrows's negligently defective design and installation had rendered it liable to appellant in terms of the main contract.

It may be remarked at the outset that by reason of this further fact appellant's rectification costs would clearly have been covered by section A of the policy had appellant made a claim upon Burrows during the insurance period. For some reason this was not done, hence appellant's need to rely on section B.

In support of the appeal counsel for appellant contended that although section A was specifically concerned with liability to third parties whereas section B did not contain express language appropriate to liability cover, section B was nevertheless also intended to provide such cover. The only important differences between the sections, said counsel, were firstly that section B provided narrower cover (the costs of rectifying defects as opposed to unlimited forms of loss); secondly that it permitted the insured, as a pragmatic expedient, to proceed forthwith to rectify defects himself (or through an agent or contractor) without having to wait until the third party made a claim upon him; and thirdly that the insurer's liability was "triggered" not by a claim made (as in the case of liability under section A) but by the occurrence of the insured's negligence.

The real substance of the policy, so proceeded the argument, was indemnity against liability for

professional negligence. Therefore the event insured against in both sections A and B was the insured' s negligence. Accordingly, as soon as such negligence occurred within the insurance period (or on or after the retroactive date) the insured acquired a vested claim against the insurer under section B, which claim simply required quantification in due course. It mattered not whether the rectification costs were incurred by the insured or by the third party to whom he was liable. It also did not matter if such costs were incurred only after the insurance period had expired. In these respects counsel stressed that nothing in section B explicitly stated that the costs had to be incurred either by the insured or within the policy period.

The fate of these contentions and, concomitantly, the answer to the questions in issue depend upon a proper construction of sections A and B of the policy.

The first feature that strikes one is that both the heading and the body of section A quite categorically declared that it indemnified the insured against liability to a third party. By contrast, section B contained no reference to liability cover. Nor did it make any reference to a third party. There is no reason why, if section B was also intended to cover third party liability, that section was not pertinently formulated to encompass such cover. In any event it is highly unlikely that it was intended to deal with substantially the same subject-matter in both sections. To suggest that it was the intention in the policy to cover such liability in section B not by clear express terminology but by obscure and highly questionable implication is therefore far-fetched.

Moreover, the interpretation advanced by appellant's counsel leads to an extraordinary result. The insurer inserted a time limit in section A by requiring that the claim by the third party had to be made within

the insurance period. That conveyed very clearly that it intended to protect itself by imposing a restriction on its potential liability. If the contention for appellant were right, no such time limit would have applied to section B and the insurer would have been exposed even years after the insurance period to a claim in respect of a third party's rectification costs.

Apart from that incongruity, the interpretation contended for is in conflict with what appellant's counsel repeatedly emphasised - with significance, I think - as the essential characteristic of the insured's position under section B. That was that, in essence, the section provided practical and convenient means whereby, immediately on his discovery that his design or work was defective, the insured could, without delay, proceed to rectify the defects before a claim was made by a third party. I am sure that that analysis is substantially correct. It is clear that nothing in section B indicates that a claim had to be made upon the insured by

a third party before he could seek indemnification under the policy. Appellant's counsel in fact conceded, rightly, in my view, that a third party claim was not a prerequisite to the insured's entitlement to this indemnity. Moreover, if section B was intended to cover only expenditure by the insured himself which was incurred soon after discovery of defects and while the work was still in progress, such a provision made sound commercial sense and rendered section B an understandable and workable supplement to section A.

Furthermore, the contention for appellant that the words "costs incurred" include costs incurred by a third party is flawed in two respects. In the first place proviso (a) to section B required that the insured prove his own negligence. By contrast, by the time of a claim by the insured under section A his negligence, as an element of his legal liability to a third party, had necessarily to have been proved by the latter by way of legal process, or agreed upon. Without such proof or

agreement the insured would have had no claim upon the insurer: Pereira v Marine and Trade Insurance Co Ltd 1975(4) SA 745 (A) at 758 A. It was accordingly not for the insured under section A to prove his own negligence. That being so I do not understand why, if the insured's liability to a third party was intended to be included within the ambit of section 8, it was for the insured to prove negligence. The requirement that he did so was therefore inconsistent with a third party being involved at all. It was entirely consistent, however, with the insured seeking reimbursement from the insurer in respect of costs which he had himself incurred.

That brings one to the second flaw which is this. The word "indemnify" means i.a "to compensate for expenses incurred" (The Oxford English Dictionary). In undertaking to indemnify the insured in section B, therefore, the insurer plainly agreed to compensate the insured in respect of what he himself had expended. If the third party had incurred the expenses and a claim had

then been made on the policy by the insured, there would have been no question of the insured being compensated for expenses incurred by him; he would merely have been the conduit for compensation due to the third party for the latter's expenses.

As to the submission that the insured event in each section was the insured's negligence, this runs counter to the plain wording of the policy. In section A even if the insured was negligent he would have had no claim under the policy until he had incurred legal liability arising out of a claim made upon him during the insurance period. It was that liability that was the event in respect of which cover was provided. Similarly, in section B the insured event was the incurring of rectification costs; the insured would have had no claim until expense had been incurred . The conclusion that it was the incurring of such costs and not the insured's negligence that was the insured event in section B is fortified by the absence of any reference to negligence

in the provision in which the indemnity was formulated. Negligence was only mentioned in proviso (a). And the function and effect of a proviso, it must be remembered, is not to constitute an independent enacting provision. It merely excepts out of the enacting provision something which, but for the proviso, would be within it; or it qualifies what is in the enacting provision: Mphosi v Central Board for Co-operative Insurance Ltd, 1974 (4) SA 633 (A) at 645 C-F.

The strained endeavour by appellant's counsel to construe the insured event in section B as being the insured's negligence, leads to an anomaly in so far as the function of the retroactive date is concerned. On that interpretation the retroactive date applied in the case of section A (where the relevant negligence could occur at any time between 1 November 1985 and 12 November 1988) but not in respect of section B (where the negligence had to occur within the insurance period). The explanation offered for this curious position was

that, as a general proposition, a retroactive date was inappropriate to the type of insurance provided by section B in that negligence occurring before the insurance period would be covered by prior insurance. That hardly assists one in the present case - from the relevant facts it does not appear that there was any prior insurance. However, if the insured event in B was the incurring of costs and the negligence concerned could occur at any time between the retroactive date and the end of the insurance period that would have allowed the retroactive date to operate with the same effect in regard to either section.

It was not in dispute that as a matter of general principle the insured event must occur within the insurance period. See Ivamy, General Principles of Insurance Law 5th ed, 376; Lawsa, vol 12 para 214.

For all these reasons I conclude that the indemnity undertaken in section B of the policy was confined to compensating the insured for rectification

costs which he incurred within the insurance period. It follows that both questions 1 and 2 must be answered in the negative.

As far as question 3 in concerned, sec 156 of the Insolvency Act provides as follows:

> "Whenever any person (hereinafter called the insurer) is obliged to indemnify another person (hereinafter called the insured) in respect of any liability incurred by the insured towards a third party, the latter shall, on the sequestration of the estate of the insured, be entitled to recover from the insurer the amount of the insured's liability towards the third party but not exceeding the maximum amount for which the insurer has bound himself to indemnify the insured."

It was not in dispute that "another person" includes an insured company. As to that, see Supermarket Leaseback (Elsburg) (Pty) Ltd v Santam Insurance Ltd, 1991(1) SA 410 (A) at 411I. The substitutionary right of action created by sec 156 can only be acquired if both the obligations referred to in the enactment are in existence. One is an obligation owed by the insurer to the insured and the other is an obligation owed by the

insured to a third party. On the grounds already advanced, respondent was not liable to Burrows and although Burrows was, as an agreed fact, liable to appellant under the main contract, section B did not cover such liability. In the result neither obligation referred to in sec 156 existed in the present matter. Consequently question 3 is also answered in the negative.

The appeal is dismissed with costs.

C T HOWIE
Acting judge of Appeal

CORBETT CJ VIVIER JA
NIENABER JA NICHOLAS AJA
Concur.