sedgwick

COVID-19 BUSINESS INTERRUPTION CLAIMS

The financial implications of the recent appeal judgment

Whilst the outcome of the appeal means that most claims for business interruption will not succeed, there will still be select policies that do respond to this event. In this update, we explore the impact of this decision and how we now expect the value of accepted claims to be materially higher as a result of the appeal decision.

Background of the appeal

On 21 February 2022, the Full Court of the Federal Court delivered the highly anticipated judgment in the appeal of the second Insurance Council of Australia (ICA) business interruption test case. The case was heard over five days — from 8 to 12 November 2021 — before Justices Moshinsky, Derrington and Colvin.

Policyholders and insurers filed appeals, cross-appeals and notices of contention for five[1] of the ten matters which were heard by Justice Jagot in the primary case during September 2021. A sixth matter[2] was added to the hearing to consolidate and expedite the appeal process.

The appeal considered several key issues concerning policy liability and the assessment of business interruptions claims. Ultimately, a large portion of the findings by Justice Jagot — which we've previously published articles on (21 October 2021 and 8 November 2021) — were upheld by the Full Court.

There were, however, several aspects of Her Honours judgment which were overruled. In particular:

1. The removal of the JobKeeper payment and government grant payments from the overall assessment of claims.
2. The addition of interest to successful claims.

Government support payments for businesses

On 30 March 2020, the federal government introduced the "JobKeeper Payment Program" which was designed to reduce the burden on the welfare system, keep employees in their jobs and support businesses impacted by COVID-19.

Many businesses, including sole traders, were eligible to receive JobKeeper payments for eligible staff. The program was available for all permanent and long-term casual residents that were Australian residents at the commencement of the program.

For each eligible employee, the business would receive $1,500 (before tax) per fortnight. Businesses were required to pass on the full amount of the JobKeeper payment as a wage payment to the employee. As the program continued, the rate of pay and the eligibly requirements for businesses and employees changed until it was wound up on 28 March 2021.

In addition to JobKeeper payments, federal and state governments also introduced a variety of grants which were designed to provide cash flow to impacted business. A majority of these payments were for fixed amounts which could be used, at the discretion of business owners, to help mitigate ongoing COVID-19 losses and to assist with the additional expenses.

The appeal decision

Justice Jagot considered that government support payments such as JobKeeper, the ATO Cashflow Boost and certain state-based payments would need to be considered against any insured losses (i.e. to reduce the quantum of the claim). The argument accepted by Her Honour was that the concept of indemnity should be upheld to prevent situations where businesses would receive a windfall gain from COVID-19 impacts. Furthermore, it was noted that JobKeeper was effectively a 'pass-through' expense. Although recorded in the accounts of a business, it was legally required to be paid to employees.

However, the Full Court overruled Justice Jagot — deciding that, for eligible claims, insurers could not take into consideration any proceeds from JobKeeper or any other government grants or payments.

The issue was considered on two grounds:

1. Whether these payments could be considered given the general principles applicable to contracts of indemnity.
2. Whether these payments would be considered in the 'savings' or 'sums saved' provisions in the respective basis of settlement clauses.

The judges sided with the appellants on both arguments. They found that the principle of indemnity could not work to override specific provisions in a contract which outline how a calculation is to be formulated.

It was also found that, despite the overall impact on the bottom line, the JobKeeper and government grant payments did not directly reduce or cease the payroll expenses of a business. In fact, the JobKeeper payments often materialised as a higher monthly expenditure figures as businesses were paying staff which would ordinarily not be paid.

Furthermore, they determined that the eligibility for JobKeeper in particular was on account of state and federal government health orders and was not a result of an outbreak, which would be the trigger for the policy.

Impact of decision on the value of accepted claims

Based on the outcome of the appeal and the general support of Justice Jagot's initial judgment, there remains limited opportunity for policyholders to make successful claims for business interruption losses. Ultimately it will come down to the specific wording and the measurable impacts of COVID-19 outbreaks, within the prescribed vicinity, which occurred prior to any widespread government orders. Notwithstanding, we expect there will still be policies that respond, though far less than could have potentially responded.

Based on our review of COVID-19 business interruption claims to date, we found that most policyholders had received significant funds from government support payments — the most significant being from the JobKeeper payment program. Further, our review found that if Justice Jagot's decision stood in respect of the treatment of these government payments, that only a fraction of accepted claims would have insurable losses; given that the government payments were so substantial.

We therefore see the appeal judgment increasing the value of losses in the following ways:

1. Reducing or removing payroll savings entirely.
2. Reducing the offset of losses from other government payments.
3. Increasing the final settlement for interest.

However, it is also likely that the decision of the Full Bench will impact the underinsurance implications for a large portion of claims, noting the majority of 'Business Pack' policies in Australia include a threshold for the application of underinsurance adjustments. Some Industrial Special Risks (ISR) policies also include this either directly or through endorsements.

Generally speaking, where a calculated business interruption loss (which is after increased costs of working and savings are considered) is less than 10% of the sum insured, underinsurance will not apply in any capacity. In our assessments to date, we have found that underinsurance was not a major issue due to the low value of the losses after savings.

By removing the JobKeeper payroll savings in particular, we will see the value of losses increase substantially for many claims, and in most cases, this will likely put the loss above the 10% threshold.

Notwithstanding the above increases in the loss totals, for policyholders which are significantly underinsured, it will decrease the payment which it would be entitled to under its policy if it had adequate cover.

Next steps to resolution

The recent decision by the full Federal Court agreed with most of the findings in the first instance judgment. This means most policies will not respond to losses arising from COVID-19.

However, the appeal decision did not agree with the initial decision in respect of government payments, government grants and interest. This has the effect of materially increasing the value of accepted claims.

The parties have 28 days from 12 February 2021 to lodge a 'Special Leave to Appeal' application with the High Court on any of the matters which were considered in the judgment. If leave is granted, then it will still be some time before a resolution is reached for policyholders and insurers.

Sedgwick contributing authors

Rodney Milford

Partner, Forensic advisory services

M. +61 403 468 206

E. rodney.milford@au.sedgwick.com

Tom O'Hara

Manager, Forensic advisory services

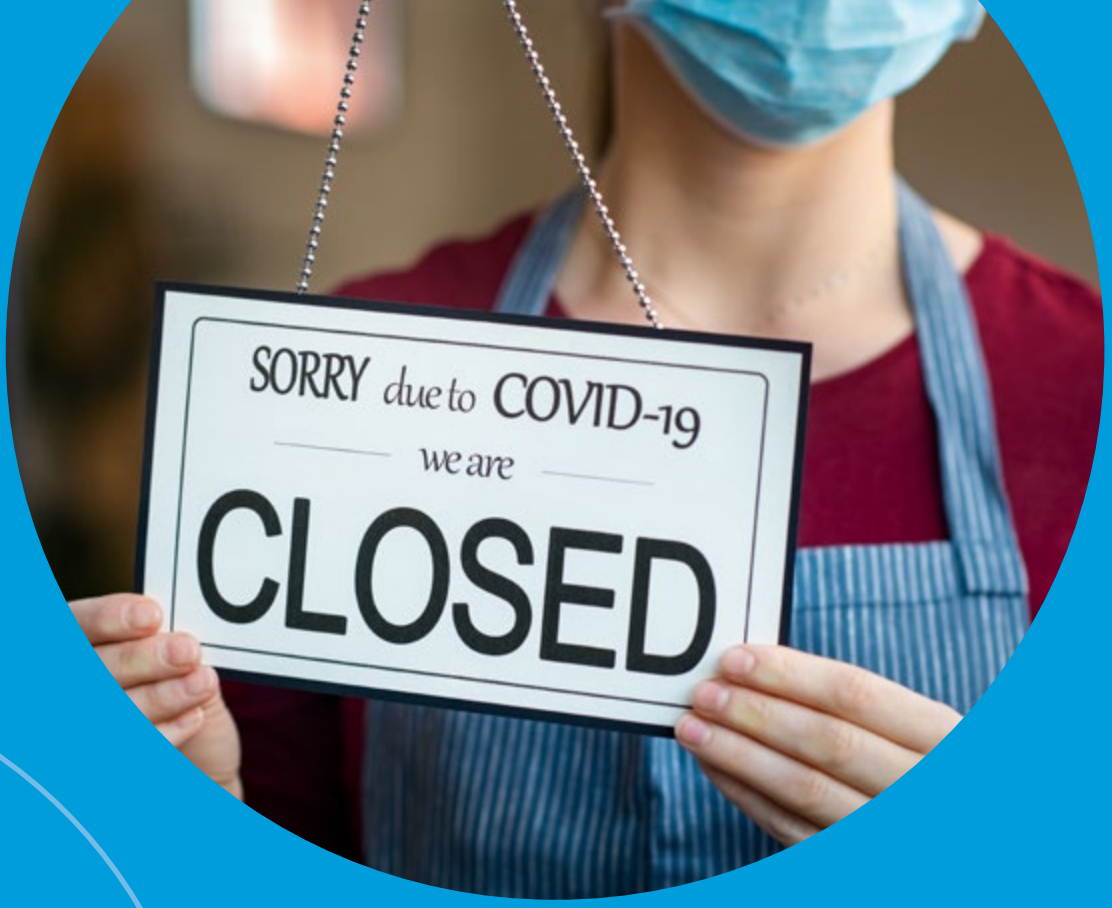
M. +61 447 521 414

E. tom.ohara@au.sedgwick.com

Sources

1 Swiss Re International Se v LCA Marrickville Pty Limited [2021] FCA 1206
Insurance Australia Limited v Meridian Travel (VIC)
Insurance Australia Limited v The Taphouse Townsville Pty Ltd
Chubb Insurance Australia Limited v Market Foods Pty Limited NSD138/2021
QBE Insurance (Australia) Limited v David Coyne in his capacity as liquidator of Educational World Travel Pty Ltd (in Liquidation) & Anor NSD308/2021

2 Star Entertainment Group Limited v Chubb Insurance Australia [2021] FCA 907



sedgwick

caring counts | sedgwick.com