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AUSTRALIA UPDATE

Business interruption policy response to COVID-19

Since the outbreak of COVID-19 in early 2020, there has been intense interest in the extent to which business interruption policies would respond to claims for business losses arising from COVID-19.

In September 2020, Sedgwick published an extensive update on the impact of COVID-19 around the globe and the potential insurance response. The publication highlighted the United Kingdom as the main region in which policies were found to respond. It highlighted that, elsewhere, only one region might find business interruption policies responding in significant numbers – that region being Australia.

In this update, we summarise recent key events in Australia, including the result of the highly anticipated judgement in the Second Test case, which was handed down on 8 October 2021.

Response of Australian policies

Business interruption policies in Australia typically contain clauses that require physical damage for the business interruption cover to be triggered and the mere existence of SARS-COV-2 (the virus causing COVID-19) is not considered to be physical damage. However, some policies contain extra covers that respond to non-physical damage and could potentially respond to business losses resulting from COVID-19[1]. Of these, there are typically two main provisions (or a 'hybrid' of the two):

1. 'Disease' clauses. There is a wide range of wordings in the Australian market to cover the impact of an outbreak of an infectious disease. These generally require the closure or evacuation of the business, by a relevant authority, as a result of an outbreak – either at the situation or within a certain distance from the situation. Importantly, these provisions regularly contain exclusions for certain diseases, as discussed in more detail below.

2. 'Prevention of access' clauses. Again, there is a range of wordings in the Australian market to cover the impact on a business that is prevented or hindered from trading due to an event that has occurred beyond its premises. These provisions normally only respond if physical damage has prevented the insured business from trading.

However, there are a small number of policy wordings that also provide cover for loss arising from orders/actions of a competent authority preventing or restricting access to insured premises because of a "threat to life" or "threat of damage to persons" (often within a specified radius of the insured premises).

Response of Australian insurers

In Australia, the above clauses are very typically found in policies referred to as "business pack" policies. Business pack policies are normally sold to small-to-medium enterprises and are designed to respond to a range of risks, to avoid smaller businesses requiring several separate policies.

It was identified that over 300,000 Australian policies could potentially respond to business interruption losses arising from COVID-19 .

However, Australian insurers have stated that it was not their intention to cover business interruption losses arising from a pandemic. As a result, insurers in Australia denied all claims citing general exclusions or exclusions within the disease provisions.

Repealed legislation referred to in exclusions

In denying claims, insurers highlighted that the exclusionary language references relevant legislation. Until 2016, the relevant legislation was the Quarantine Act 1908. However, this was repealed in 2016 and replaced with the Biosecurity Act 2015. With the outbreak of the pandemic, these exclusions came under intense scrutiny and it was identified that whilst some policies referred to the new legislation, many policies containing the disease clause either did not contain an exclusion or the exclusion referred to the repealed legislation.

Test cases

First Test case

In July 2020, as a result of the uncertainty as to whether insurers could rely on an exclusion which referred to the repealed Quarantine Act 1908, insurers, with the support of the Australian Financial Complaints Authority (AFCA)[2], launched what is now known as the First Test case.

The First Test case[3] was heard in the NSW Court of Appeal on 2 October 2020 with the decision delivered on 18 November 2020[4] The court found that the reference to the Quarantine Act 1908 should not be construed as a reference to the Biosecurity Act 2016. The decision meant that exclusions referring to the repealed legislation did not apply and the disease clause could be triggered for claims arising from COVID-19.

Following the decision, insurers sought leave to appeal to the High Court of Australia. Oral submissions were heard on 25 June 2021 and leave to appeal was rejected.

Implications of the outcome of the First Test case

As a result of this outcome, insurers are unable to rely on any exclusion that referred solely to the Quarantine Act 1908.

This has meant insurers and the AFCA can assess certain business interruption claims. This applies to claims where it was clear that the policy would respond, such as cases where a business had been ordered to close as a result of an outbreak of COVID-19 at its premises. Our understanding is that there has only been a relatively small number of instances where policies have responded in this manner.

Second Test case

Whilst the First Test case provided certainty in respect of exclusions within the disease clause, it did not address how the insuring clauses would respond to the COVID-19 pandemic.

As a result, a Second Test case was commenced in February 2021[5]. The Second Test case initially started with nine different policies from five different insurers. A tenth case (Educational World Travel[6]) was later added due to the potential significance of the arguments put forward by the insurer around the Property Law Act (VIC). The policies were for businesses as diverse as travel, hospitality and health.

The Second Test case sought to test the insuring clauses of each policy and gain clarity on how certain factors unique to the government response to COVID-19 should be addressed in the quantification of claims. An extensive number of issues were put to the court for consideration, including:

- What amounts to an outbreak occurring within a defined radius of the insured premises? Does it require a minimum number of confirmed cases and/or community transmission within the radius?
- Were orders of relevant authorities to close business premises made because of an outbreak affecting, or likely to affect, the insured business?
- What amounts to 'closing all or part of the premises' or 'prevention or restriction of access to a premises'?
- Is contracting COVID-19 a form of 'damage… to persons'? If yes, what amounts to a 'threat of damage' to persons within the defined radius?
- To what extent should the trends or adjustments clause take into account the "broader" impacts of COVID-19?
- How should JobKeeper[7] be treated? Does it offset the insured loss?
- How should the receipt of government grants to businesses be treated? Should they be offset against the insured loss?

Outcome of the Second Test case

On 8 October 2021, Justice Jagot delivered judgment in the Second Test case[8].

The outcome was largely in favour of insurers, with her Honour finding in respect of nine of the ten policies that the insuring clauses did not apply in the circumstances. In the remaining case, her Honour found that the insuring disease clause did respond, but noted that there are substantial issues as to whether the policyholder can prove an entitlement to indemnity.

We note some of the key findings within the judgment below:

- **Occurrence of COVID-19** – her Honour found that an occurrence of COVID-19 means an event or case of COVID-19 in any setting (controlled or non-controlled environment)[9].
- **Outbreak of COVID-19** – her Honour found that an outbreak of COVID-19 requires only one case of active COVID-19 in the community (i.e. a non-controlled environment)[10].
- **Disease clauses –** it was found that these clauses did not respond. Her honour distinguished the current cases from the decision in FCA v Arch (UKSC)[11] in a number of ways, noting that the outbreak in the UK, with a dense population, was widespread. In the UK case, it was found that each and every case both inside and outside the relevant area[12] was an equally effective cause of the actions of the UK Government. In contrast, her Honour found in Australia it has not been possible to conclude that any State Government action was caused by, or resulted from, or was in consequence of, the existence or likely future existence, of any case of COVID-19 at the insured's location or within the area required by the insuring clauses[13].
- **Prevention of access clauses –** it was found that, whilst these clauses could potentially respond, her Honour found that it cannot be the intention of the parties for a prevention of access clause to respond where the threat related to a disease[14]. As such, she found in all cases where both a disease and prevention of access clause existed, that the policy would only be capable of responding by way of the disease clause.
- **Threat of damage to persons –** it was found that "damage" to persons means injury not illness.

Notwithstanding that her Honour found that the policies did not respond, the judgment contained guidance as to how her Honour would expect the calculation of the loss (quantum) to be undertaken. A number of key quantum-related issues are addressed in the judgement:

1. **Trends/adjustment clause –** her Honour followed the FCA v Arch UKSC ruling which found the Orient-Express case was wrong and instead found that the "but for" test cannot be used to exclude losses in consequences of the same underlying cause as the insured peril[15]. She did find however, that losses from the Federal Overseas Travel Ban (e.g. for a travel company) were from a different underlying cause than State closure orders. Thus, the "but for" test can still be relevant in some cases.
2. **JobKeeper receipts –** it was found that amounts received by businesses towards the cost of wages should be taken into account in the calculation of saved expenses[16].
3. **Government grants –** her Honour characterised the various state government grants as an "act of grace" and stated they should not be taken into account in assessing the business interruption loss[17]. Only two exceptions to this were noted of the grants her Honour examined. The first was a grant provided to certain small businesses in South Australia. In the accompanying press release for this grant, it stated it was provided to help cover a business' operating costs. As such, her Honour characterised it as intended to reduce a business's losses from restrictions imposed on business due to COVID-19 and found it should be taken into account in assessing the business interruption loss[18]. The second was the Commonwealth Government's "Cash Flow Boost"[19].
4. **Other savings –** her Honour found that expenses which reduced as a result of COVID-19 cannot be disregarded in the calculation of savings. This includes items such as rent waivers and franchisor relief[20].
5. **Interest –** her Honour found that it was not unreasonable to withhold payment of the claim and as such, interest would only apply from the date of a "final determination of this case[21]," being once all appeals had been finalised.

Appeal of the decision to the full bench of the Federal Court of Australia

Anticipating the intense interest in the outcome of this matter, the Federal Court has set aside dates for the full bench of the Federal Court of Australia to hear an appeal in the Second Test case between 8 and 12 November 2021. Her Honour has granted leave to appeal to all parties. It has been suggested that a decision on the appeal could be available in December 2021. Notwithstanding this, many commentators expect that an outcome on the appeal will not be an end to the matter. Given the number and value of potential claims, it is possible that leave will be sought to appeal to the High Court, the highest court in the Australian judicial system.

Implications of the outcome of the Second Test case

We expect insurers will now be reviewing the judgment and comparing it to their range of policy wordings.

Whilst the appeal process is underway, we do not anticipate that the claims of any policyholders whose policies may respond will be finalised until the appeal process is finalised.

Class actions

Whilst much of the focus in 2021 has been on the progress of the two test cases, during this time several class actions have commenced against insurers relating to the response of business interruption policies to COVID-19.

These class actions have been stayed until February 2022, pending the outcome of the appeal of the Second Test case.

Potential resolution of a complex issue

In the judgment, Justice Jagot summarises the causal and non-causal elements which must exist to prove causation under non-physical damage within business interruption policies in Australia:

"The insurance policies use various words to describe the causal relationship which must exist between the elements of the insured perils (in consequence of, consequent upon, as a result of, likely to result in, caused by, caused by or results from, resulting from, in direct consequence of, arising from, leading to, arising directly or indirectly from). The elements of the insured perils also require other relationships to exist which are not causal, such as temporal relationships (for example, during), spatial relationships (for example, at a location, within a specified radius), physical relationships (such as preventing, restricting), and substantive relationships (for example, by order)[22]."

The above highlights the complexity that policyholders, insurers and the courts have encountered thus far to determine the response of policies to COVID-19.

Given the progress that has been made in the United Kingdom since the outcome of the FCA case, with a majority of claims now having been finalised, it is hoped that a quick resolution to the appeal process, potentially by the end of 2021, will likewise provide certainty in Australia.

The Sedgwick team will provide further commentary as developments occur.

Sedgwick contributing authors

Kimberley Daley, B.Bus FCPA
Head of professional services Australia
kimberley.daley@au.sedgwick.com

Leon Briggs, BCA (Hons) CA FCILA FCLA ANZIIF (Fellow) CIP
Head of property and national executive MCL adjuster
leon.briggs@au.sedgwick.com

Emma Levett, B.Comm MForAccy CPA
Partner & head of forensic advisory services Australia
emma.levett@au.sedgwick.com

Rodney Milford, B.Bus (Accounting)
Partner, forensic advisory services
Rodney.milford@au.sedgwick.com

Tom O'Hara, B.Com CA
Manager, forensic advisory services
tom.ohara@au.sedgwick.com

Sources

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2 AFCA operate as an ombudsman for financial complaints
3 HDI Global Specialty SE v Wonkana No.3 Pty Ltd [2020] NSWCA 296
4 Judgement in the First Test Case link: https://www.caselaw.nsw.gov.au/decision/175d83c4c19face7f3e6bc2c
5 Swiss Re International Se v LCA Marrickville Pty Limited (Second COVID-19 insurance test cases) [2021FCA] 1206
6 David Coyne in his capacity as liquidator of Educational World Travel Pty Ltd
7 The JobKeeper Payment scheme introduced by the Australian Government and was a subsidy for businesses significantly affected by COVID-19.
8 Judgment in the matter of Swiss Re International Se v LCA Marrickville Pty Limited (Second COVID-10 insurance test cases) [2021] FCA 1206 https://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2021/2021fca1206 ("Judgment in the Second Test case")
9 Paragraph 95 of the judgment in the Second Test case
10 Paragraph 96 of the judgment in the Second Test case
11 The Financial Conduct Authority v. Arch Insurance (UK) Limited and Others case was brought by the FCA on behalf of business interruption (BI) policyholders who claimed financial losses resulting from COVID-19 in the United Kingdom.
12 Certain policies specify an area or radius from the Premises or Situation in the insuring clause
13 Paragraph 79 of the judgment in the Second Test case
14 Paragraph 561 of the judgment in the Second Test case
15 Paragraph 378 of the judgment in the Second Test case
16 Paragraph 405 of the judgment in the Second Test case
17 Paragraph 408 of the judgment in the Second Test case
18 Paragraphs 783 and 784 of the judgment in the Second Test case
19 Paragraph 630 of the judgment in the Second Test case
20 Paragraphs 410 and 413 of the judgment in the Second Test case
21 Paragraph 516 and 631 of the judgment in the Second Test case
22 Paragraph 41 of the judgment in the Second Test case

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