Ten significant issues decided by the Federal Court in the second business interruption test case

October 14, 2021

Background

On Friday October 8, 2021, the Federal Court handed down judgment in the second business interruption test case *Swiss Re International Se v LCA Marrickville Pty Limited (Second COVID-19 insurance test cases) [2021] FCA 1206* (**Second Test Case**). The Second Test Case concerns the proper construction of policy clauses relating to claims for business interruption in the context of the COVID-19 pandemic.

The judgment concludes that for nine of the ten proceedings in the Second Test Case, business interruption claims are not covered. A full copy of the judgment can be accessed **here**.

The judgment is an important step towards reaching a final outcome and providing direction on cover for business interruption claims relating to the COVID-19 pandemic in Australia. An appeal of the decision has been fixed for November 8, 2021 where the court (Full Federal Court) will again consider the parties' arguments.

Introduction to issues in Second Test Case

The Second Test Case consists of ten distinct small business claims across a range of business sectors and locations. While the Second Test Case involves six insurers Allianz, Chubb, Guild, IAG, QBE, and Swiss Re, the significance of the decision lies in its applicability to Australian businesses and insurers generally.

Each proceeding in the Second Test Case had a number of issues for determination, the scope of which is reflected in the 385 page judgment of Jagot J.

In this article, we summarise ten significant issues that her Honour decided and that the Full Federal Court will again consider.

The hybrid, prevention of access, disease, and catastrophe clauses considered in the Second Test Case are set out **in this table** adapted from pages 35 to 38 of the judgment.

Ten significant issues

Issue 1 – 'outbreak'

The issue of what constitutes an 'outbreak' arises in several cases. The court is asked to consider the meaning of an 'outbreak' and whether it must involve something more than a single instance of COVID-19.

Her Honour finds that an 'outbreak' of a disease takes its meaning from the nature of the disease, and that in the case

of COVID-19 there can be an ‘outbreak’ of COVID-19 within a specified area if there is an active (contagious) case of COVID-19 within the community that is not in a controlled setting (such as a hospital or isolation or quarantine). Due to the highly contagious nature of COVID-19, it was not considered necessary to prove that a person transmitted to another person within an area.

An ‘outbreak’ is distinguished from an ‘occurrence’ which is an event or case of COVID-19 in any setting including in a hospital or isolation or quarantine.

Issue 2 – ‘radius’

The interpretation of radius provisions provides for interesting arguments as to the difference between the impact of COVID-19 in the UK and in Australia.

Insurers’ submissions in the Second Test Case include that the UK Supreme Court decision of *The Financial Conduct Authority v Arch Insurance (UK) Ltd [2021] AC 649; [2021] UKSC 1* (**FCA v Arch**) should not be followed as the UK response was national and the outbreak was spread over almost the entire geographic area.

Her Honour distinguishes the context in FCA v Arch from the Second Test Case by reference to a number of points including the following:

1. The UK has a unitary system of government with actions taken at a national level.
2. The UK is small in area and densely populated.
3. The outbreak of COVID-19 in the UK was widespread.

Her Honour finds that in the context of these matters that each and every known case of COVID-19 in any location in a State was not an equally effective cause of the State government actions.

Issue 3 – ‘closure’

In considering ‘closure’, the court is asked to consider a number of different aspects of closure. For example, whether there was actual closure of the premises, rather than a mere restriction (such as due to a travel ban).

The distinction between ‘premises’ and ‘business’ is also an important consideration as several similar clauses to the example provided above covered business interruption to the ‘business’ caused by closure of the ‘premises’ or ‘situation’.

Her Honour at [98] clarifies a number of matters in respect of closure which include the following:

1. It is not possible to apply any pre-conceived concept that a mere restriction on the operation of a business does not require a closure of the premises/situation.
2. Closure of premises/situation is different from closure of a business.
3. Closure requires that the whole or part of the premises/situation be closed off from entry by persons who otherwise would ordinarily be entitled to enter and remain on the whole or that part of the premises/situation.
4. Closure does not require physical impossibility of access to the whole or part of the premises/situation.
5. Closure does not require that each and every person is prohibited from entering and remaining upon the whole or part of the premises/situation but it requires that persons who would otherwise be entitled to do so, not be able to do so.
6. If a premises/situation involves a business catering to the public and the public is not able to enter and remain upon the whole of the premises/situation or a part of the premises/situation, the premises/situation may well be closed in whole or part.

Issue 4 - order of a legal authority

The question of whether specific directions are orders of a legal authority within the meaning of the relevant policy

was not in dispute in the majority of test cases.

Her Honour, also at [98], clarifies a number of matters in respect of orders by a legal authority which include the following:

1. A ‘public authority’, ‘statutory authority’, ‘government authority’, ‘civil authority’, ‘lawful authority’ in the context of the insuring provisions, means an authority, body or person authorised or empowered to take the action by reason of an Act, regulation or instrument of any kind under an Act, regulation or instrument.
2. The action must have some essentially public as opposed to private character.
3. A legal authority does not mean an authority, body or person authorised or empowered to take the action by reason of a private arrangement such as a contract or by-laws of a body corporate.

Issue 5 - discovery of an organism

The organism considered for discovery is severe acute respiratory syndrome Coronavirus 2 (SARS-CoV-2) which is the virus that causes the disease COVID-19.

A consideration in a number of cases is whether the discovery of an organism must be at a premises or situation. In this regard, her Honour warns against generalisation in relation to whether the discovery of an organism must be at the premises or situation noting that it depends on the wording of the particular provision.

Issue 6 - causal sequence

Insurers rely on FCA v Arch (at [97] of that case) in arguing that hybrid clauses in insurance policies of the type under consideration involve a series of elements which are causally connected, and that in order to trigger an insurer’s obligation to cover and indemnify for loss, the insured must demonstrate that those causally linked events have occurred in the prescribed order.

For example, in IAG v Meridian Travel NSD133/2021, IAG argued that the correct causal sequence is as follows:

(A) an outbreak of disease or threat of damage to property or persons, which causes (B) an order of a public or legal authority, which causes (C) the prevention or restriction of access or closure of the premises, which causes (D) an interruption or interference with the insured’s business that is the direct cause of financial loss.

This is expressed diagrammatically as was done (at [26]) in FCA v Arch with each arrow representing a causal connection, as follows:

A -> B -> C -> D

The main contest between insurers and insureds with regard to such sequences is with respect to closure (or (C) in the above sequence). For such types of clauses, her Honour finds that cover exists for loss from orders/actions of a competent authority closing or restricting access to premises, only where those orders/actions are made or taken as a result of infectious disease or the outbreak of infectious disease within a specified radius of the insured premises. Thus, in the many cases, cover will not be available under hybrid clauses.

Her Honour also clarifies that insurers were incorrect in arguing that the specified circumstances such as in (A) had to exist as an objective fact highlighting that the start of the causal sequence is the making of the order by the authority (for example, (B) above). The order of the authority does have to be for the reason identified in a clause but insurers are not allowed rely on the authority being right or wrong in making the order.

Issue 7 - Property Law Act 1958 (Vic)

An issue which arises in the Second Test Case relates to an exclusion the subject of the first business interruption test case *HDI Global Specialty SE v Wonkana No. 3 Pty Ltd* [2020] NSWCA 296 (First Test Case) and the operation of

section 61A of the Property Law Act 1958 (Vic) which states:

61A Construction of references to repealed Acts;

Where an Act or a provision of an Act is repealed and re-enacted (with or without modification) then, unless the contrary intention expressly appears, any reference in any deed, contract, will, order or other instrument to the repealed Act or provision shall be construed as a reference to the re-enacted Act or provision.

In the First Test Case, it was found that the reference in a policy excluding cover for "diseases declared to be quarantinable diseases under the [repealed] Quarantine Act 1908 and subsequent amendments" could not be construed as extending or referring to "diseases determined to be listed human diseases under the Biosecurity Act" which was enacted on the same date as the Quarantine Act was repealed.

Guidance on the operation of section 61A was an important consideration in relation to Victorian businesses impacted by COVID-19, which was not previously determined in the First Test Case.

If section 61A applies as insurers contend in three of the proceedings, the reference in the exclusion provisions of the contracts of insurance to a "quarantinable disease under the Quarantine Act 1908 (Cth)", now repealed, could be construed as a reference to a "listed human disease under the Biosecurity Act 2015 (Cth)", due to the Biosecurity Act being deemed to be a re-enactment with modifications of the Quarantine Act, and as a result, loss resulting from COVID-19, a listed human disease under the Biosecurity Act, is excluded from the scope of the cover under the contracts of insurance.

Her Honour finds against insurers for the following reasons:

1. The reference to "Act" in section 61A means an Act of the Parliament of Victoria in accordance with section 38 of the Interpretation of Legislation Act, and therefore does not refer to the Quarantine Act as a law of the Commonwealth.
2. The Biosecurity Act is not a re-enactment with modifications of the repealed Quarantine Act due to it representing a radical alteration from the previous process of declaring a quarantinable disease under the Quarantine Act.

Issue 8 – catastrophe clause

A catastrophe clause arose for consideration in the case of Swiss Re v LCA Marrickville NSD132/2021.

The particular catastrophe clause in that case is as follows:

The Insurer will indemnify the Insured in accordance with the provisions of Clause 10 (Basis of Settlement) against loss resulting from the interruption of or interference with the Business, provided the interruption or interference … is in consequence of … the action of a civil authority during a conflagration or other catastrophe for the purpose of retarding same;

Her Honour's first basis for finding that there is no catastrophe cover is as another insuring provision specifically dealt with diseases, incoherence associated with extending the subject matter in the above clause to deal with diseases should be avoided.

Her Honour also separately finds that this particular clause had nothing to do with diseases.

While her Honour accepts that a pandemic is a "catastrophe" in its ordinary sense the operative words "conflagration or other catastrophe" and "retarding" suggested a physical event.

The basis for this finding includes:

1. Conflagration means a "large and destructive fire".
2. Catastrophe must be an "other catastrophe.

3. The linking of “other catastrophe” with “conflagration” indicates that the other catastrophe is to be of a kind similar to a conflagration, which involves a physical event.

The conclusion on interpretation of catastrophe clauses adds further to the existing Australian jurisprudence on this area, following the Federal Court decision in *The Star Entertainment Group Limited v Chubb Insurance Australia Ltd & Ors* [2020] FCA 907. Our insights on the related Star decision can be accessed **here**.

Issue 9 - Section 57 of the Insurance Contracts Act 1984 (Cth)

Section 57 of the Insurance Contracts Act relates to insurers liability for interest. Subsection 2 provides that the period in respect of which interest is payable is the period commencing on the day as from which it was unreasonable for the insurer to have withheld payment of the amount and ending either when payment was made or sent by post.

The issue arising under subsection 2 concerns the time from which it would be unreasonable for the insurer to withhold payment. The insureds’ position is that any liability for interest should start from when the claim was either fully investigated or declined, not from the date of judgment on the issue.

Insurers argue that the court should take into consideration insurers’ participation in the Test Case as applicants, expeditious advancement of the test case, the necessity for the courts adjudication to resolve the claims, and in some instances the failure to provide information relevant to loss on the claim as evidence of reasonableness.

Her Honour finds that it would not be unreasonable for the insurers to withhold payment unless and until it is finally determined to be liable to make payment in the Second Test Case.

Issue 10 - Adjustment

A key issue in relation to different adjustment provisions is the extent to which insurers must make adjustments (when cover exists) for consequences of COVID-19 other than consequences related to damage defined under the policy. This is relevant to losses arguably not caused by damage under the policy (for example, a change in the attitudes of consumers).

Insureds rely on FCA v Arch arguing that such adjustment should only reflect circumstances which are unconnected with the insured peril and not circumstances which are inextricably linked with the insured peril in the sense that they have the same underlying or originating cause.

Her Honour finds that as in FCA v Arch, trends clauses which use a “but for” requirement cannot be construed as requiring an adjustment for circumstances involving the same cause of loss as the insured peril as the parties cannot be taken to have intended that the same underlying cause of insured and uninsured loss must be taken into account when considering adjustment.

Way forward

While there will be an appeal of some or all of the test cases and in some of those cases a cross-appeal, the decision is an important step in reaching a final outcome in respect of cover for COVID-19 under business interruption policies.

Further information

Litigation and Dispute Resolution Partner, Louise Massey, and Senior Associate, Finbarr O’Connell are currently acting in the Second Test Case. Please contact us if you wish to receive updates on developments about the Second Test Case or any other matters.

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