HERBERT SMITH FREEHILLS

PRESSURE POINTS: INSURANCE COVER FOR COVID-19 RELATED FINANCIAL LOSSES? (AUSTRALIA)

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Legal Briefings – By **Mark Darwin**

There has been significant debate about insurance coverage for financial losses associated with COVID-19.

Uncertainty exists because of the absence of any 'physical damage' to insured property,[1] which typically triggers the 'business interruption' (**BI**) coverage in the industry standard Industrial Special Risks (**ISR**) policy.

Policyholders have therefore looked for policy triggers under 'non-damage' BI extensions – such as where the business is interrupted by infectious disease or by the actions of authorities. Insurers have protested that pandemic related losses were never intended to be covered, leaving policyholders either without insurance or considering their next move in what will inevitably be regarded by insurers as a controversial claim.

In an effort to bring some certainty to the issues, the UK Financial Conduct Authority (**FCA**) has, with the cooperation of eight British insurers,[2] commenced a test case seeking declarations from the UK High Court on the operation of several non-damage BI extensions. After an expedited exchange of pleadings and submissions based on representative sample policy wordings, the court hearing commenced on 20 July and is expected to conclude in early August.

Herbert Smith Freehills is representing the FCA to advocate the policyholder's position on the issues.

KEY ISSUES IN THE TEST CASE

The test case is considering the various issues which have been raised in the debate over coverage in 2 broad categories:

1. **The 'coverage' issues** – that is, whether the various circumstances relied upon by policyholders do trigger the policy coverage; and

2. **The 'causation' issues** – that is, whether the losses were caused by the policy trigger, or by the wider impact of COVID-19 in the community. This issue includes consideration of the 'adjustments clause' which typically requires a consideration of trends and other circumstances which would have affected the business anyway in estimating the hypothetical results which would have been achieved before comparing those with the policyholder's actual results.

These issues would be equally significant to a non-damage BI claim in Australia.

COVERAGE ISSUES

Some of the main coverage issues on which the Court is asked to make declarations include:

WHETHER THE EXCLUSION OF PANDEMICS FROM THE INFECTIOUS DISEASES EXTENSION EVIDENCES AN INTENTION THAT THERE IS TO BE NO COVER FOR PANDEMICS UNDER ANY NON-DAMAGE BI EXTENSION?

This is similar to the position in Australia where policies extend BI cover to circumstances where an infectious disease is located at the insured premises - but then excludes diseases such as COVID-19 which are notifiable under the *Biosecurity Act*. There has been some debate in Australia about whether the reference in some policies to the now repealed *Quarantine Act* (which has been replaced by the Biosecurity Act) is sufficient to exclude diseases such as COVID-19 which would have been notifiable under that repealed legislation. This latter point will not be decided in the UK test case but there are a couple of things to say about this issue.

First, the extension usually only applies where there is a disease at the premises – and in most circumstances there is no COVID-19 on the premises – so there is generally no cover triggered under this extension, meaning the exclusion does not come into play to be considered.

Second, the exclusion is typically not a general exclusion – it is often only a limitation on the types of infectious diseases on premises which trigger the cover. As a result, in most cases the so-called 'pandemic exclusion' will not come into play. Nevertheless, the insurers in the test case argue that the lack of a general exclusion of loss caused by pandemics is unnecessary because the policy provides cover only for specific insured perils (which do not include pandemics).

The policyholder's position is that if other non-damage extensions apply to trigger the cover, there is no reason to construct the policy to imply an intent to exclude pandemics generally.

WHETHER THE GOVERNMENT RECOMMENDATIONS WERE 'ACTIONS' BY AUTHORITIES?

While insurers concede that legislated government action enforceable by law may be sufficient to trigger coverage, they seek to make a distinction with government advice and recommendations to the public, which they say does not satisfy the definition of 'action'.

The policyholder's position is that all action, instructions, advice and recommendations by the government were actions by authorities within the meaning contemplated by the policy. The FCA argument contrasts the more compelling nature of government recommendations in relation to COVID-19 with advisory nature of health recommendations such as to avoid smoking or to eat 5 veggies and 2 serves of fruit a day. In Australia, the policyholder's position on this issue is made much easier by the fact that most of the government actions have the enforceable backing of State health legislation.

WHETHER THE ACTIONS BY AUTHORITIES WERE IN THE VICINITY OF THE INSURERS PREMISES?

Insurers are seeking to limit the trigger to situations where COVID-19 has been identified within a stated vicinity of the insured premises.

The policyholder's position is that the pandemic was a nationwide emergency threatening life and the actions applied to the whole of the country, therefore the actions necessarily included the vicinity of all locations within the country.

WHETHER ACCESS TO PREMISES HAS BEEN PREVENTED, DENIED OR HINDERED BY THE CIRCUMSTANCES?

Insurers are arguing that, unless directly ordered to be closed by authorities, access to businesses was not prevented, restricted or hindered.

The policyholder's position is that requirements for social distancing, self-isolation, stay at home advice and travel restrictions meant that for all businesses where access to or use of the premises was material, there was a prevention, restriction or hindrance on use of the premises within the meaning of the policy. Some businesses may have stronger arguments here – for example, gyms which were prohibited from opening, restaurants that were limited to 'take-away only' trade, and stadiums which could not host events without infringing upon mass gathering and social distancing rules.

CAUSATION ISSUES

Once the potential trigger has been identified, it is then necessary to establish that the insured trigger was the 'proximate cause' of the loss (i.e. the dominant or operative reason). If that is established, the loss recoverable is then assessed under the policy's basis of settlement formula. Central to both of these enquiries is a consideration of the 'counterfactual', that is, what would the results of the business have been had it not been interrupted or interfered with? The questions are follows:

1. In regards to proximate cause – insurers argue that if the business would have suffered anyway due to wider COVID issues then the insured trigger cannot be the 'proximate cause' of the loss.

2. In regards to the 'adjustments' clause – insurers argue that in any event the policyholder's standard results must be adjusted to take into account the wider COVID circumstances which would have affected the results of the business regardless of the actions of authorities.

DOES THE ADJUSTMENTS CLAUSE APPLY TO NON-DAMAGE TRIGGERS?

Policyholder's first argument is to whether the adjustments clause applies at all to non-damage extensions. This is because the clause refers in several places to the results which would have been achieved 'but for the Damage'. The insurers' argue that the non-damage trigger is substituted for the term 'Damage' in the adjustments clause (so that, for example, the question would be what would the results have been but for the action by authorities).

The contrary view, put forward by the policyholders, is that why should this clause have any application at all where the policy is not triggered by Damage? This is argued to be especially so where the insurers have taken care to define 'Damage' as physical damage to property and yet have given extensions to the coverage in specific non-damage scenarios.

WHAT IS THE CORRECT COUNTERFACTUAL SCENARIO FOR THE ADJUSTMENTS CLAUSE?

Insurers have long taken the view in situations of wide area damage that claims are to be calculated upon the assumption that only the insured Damage is disregarded, but all other circumstances (including those occurring concurrently with the Damage) still occurred. So, for example, when a New Orleans hotel damaged by Hurricane Katrina lodged a claim based on its standard occupancy, the Court held that the correct counterfactual scenario in which the hypothetical standard occupancy must be assessed was an undamaged hotel in an otherwise flooded city.[3] Upon that long standing principle, insurers in the test case argue that the counterfactual should remove just the trigger (e.g. removing the government action in response to COVID-19 in the vicinity of the premises) but with everything else remaining the same including the pandemic itself, government response to the pandemic elsewhere (outside of the vicinity) and the public's response to the pandemic and economic downturn. The result of that, insurers contend, is that the policy trigger did not cause the loss because loss would have occurred anyway given the other factors.

As for the 'adjustments clause', it is being argued for policyholders that this is intended to take into account extraneous circumstances which would have occurred anyway but does not apply to exclude the impacts of the natural and inevitable results of the insured peril which has resulted in the loss to the policyholder. That is, the adjustment clause is not intended to rerun a causation test to essentially throw out the back-door a claim which had validly passed through the front door by satisfying the proximate cause test. The policyholder's argument therefore is that in claims like this where there are concurrent causes of the loss which are interdependent and interlinked (such as the pandemic and the actions by the authorities) then the correct counterfactual is a hypothetical scenario in which neither occurred (i.e. no pandemic and no actions by authorities, or whatever relevant non-damage BI trigger is relevant).

CONCLUSION

We will keep readers updated on developments and report on the outcome of the test case and its implications for claims in Australia.

If you would like to discuss the test case or your own non-damage BI cover in the meantime, please get in touch.

ENDNOTES

1. For most businesses there has been no COVID-19 at the insured premises – and even if there was it would be necessary to establish that the disease amounts to 'damage to insured property', which in Australia at least is unlikely to succeed.

2. The insurers are (1) Arch; (2) Argenta; (3) Ecclesiastical; (4) Hiscox; (5) MS Amlin; (6) QBE; (7) RSA; (8) Zurich.

3. *Orient-Express Hotels Ltd v Assicurazioni General SpA* [2010] EWHC 1186 (Comm).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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