HERBERT SMITH FREEHILLS

UPDATE ON COVID-19 BUSINESS INTERRUPTION INSURANCE: A FURTHER WIN FOR AUSTRALIAN POLICYHOLDERS

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Legal Briefings – By **Mark Darwin, Guy Narburgh and Travis Gooding**

Policyholders have won the first of a number of Australian test cases about insurance cover for Covid-19 related business interruption losses.

In a 5-0 decision, the NSW Court of Appeal held that an exclusion in the infectious diseases extension for quarantinable diseases notified under the "*Quarantine Act 1908 (Cth) and subsequent amendments*" did not exclude listed human diseases under the *Biosecurity Act 2015* (Cth).

This does not mean that all claims for Covid-19 related business interruption losses must now be paid – it simply means that businesses holding policies which were not updated when the *Quarantine Act* was repealed in 2015 and replaced by the *Biosecurity Act* now have one less hurdle to overcome in presenting their claim. Causation issues such as whether the outbreak of the disease or "other circumstances" (such as government action and/or the downturn in the economy) caused the loss still need to be considered, although those issues were largely resolved in favour of policyholders in the recently decided UK FCA test case (which is currently under appeal).

Insurers do not have an automatic right to appeal the Australian ICA test case but have until mid-December to decide whether they believe they have grounds to apply to the High Court for special leave to appeal the decision.

ICA TEST CASE: BACKGROUND

Our previous update (here) included a discussion on the background and status of three test cases currently on foot in Australia.

The decision on 18 November is in relation to the ICA test case. Specifically, the case tested claims by policyholders who held cover for business interruption (BI) losses arising from an outbreak of infectious disease with a 20km radius of the insured premises but which excluded "*diseases declared to be quarantinable diseases under the Quarantine Act 1908 and subsequent amendments*".

The *Quarantine Act*, which lists a number of diseases such as SARS, was repealed in 2015 and replaced by the *Biosecurity Act*, which introduced a similar but not identical regime for diseases to be "listed human diseases". Covid-19 was listed under the *Biosecurity Act*, but some policies (represented by the 2 specifically considered in the test case) still refer to the *Quarantine Act*. Those insurers sought a declaration that policies which still refer to the "*Quarantine Act and subsequent amendments"* should be interpreted as a reference to the *Biosecurity Act*.

The ICA test case was leapfrogged straight to the NSW Court of Appeal and heard by 5 judges in a special sitting on 2 October 2020.

ICA TEST CASE: DECISION

All 5 judges found in favour of the policyholders. The judgment is a masterclass in the law of contractual interpretation, but the decision came down to 2 key questions.

DO THE WORDS "*QUARANTINE ACT 1908 AND SUBSEQUENT AMENDMENTS*" INCLUDE THE *BIOSECURITY ACT*?

All five judges held "no", and did so for similar reasons. In short, the Court found no ambiguity in the words and gave effect to their express meaning. In particular, it was held that:

a. The expression 'subsequent amendments' is not ambiguous. It only describes amendments to the Quarantine Act. The repeal and replacement of that Act with the Biosecurity Act is not an 'amendment' of the Quarantine Act.

b. The word 'subsequent' meant that if the Quarantine Act were amended during the period of the policies, the policies would incorporate those amendments.

c. The purposes and subject matter of the Quarantine Act and Biosecurity Act are similar – excluding diseases that are sufficiently serious to attract a public health response. But the mechanisms by which diseases are notifiable under the Quarantine Act and listed

> under the Biosecurity Act are different. The policies specified the mechanism for identifying the diseases which they excluded, and a different mechanism should not be imported.

In the words of Meagher JA and Ball J: "*To suggest that the words "and subsequent amendments" include the enactment of the Biosecurity Act is many steps too far."* Quoting a 1997 House of Lords decision:[1]

> *"There comes a point at which the court should remind itself that the task is to discover what the parties meant from what they have said, and that to force upon the words a meaning which they cannot fairly bear is to substitute for the bargain actually made one which the court believes could better have been made. This is an illegitimate role for a court."*

WERE REFERENCES TO THE QUARANTINE ACT A MISTAKE THAT SHOULD BE CORRECTED TO GIVE EFFECT TO THE OBJECTIVE INTENTION OF THE PARTIES?

Again, all 5 judges agreed that the answer to this question was 'no', although there was a slight divergence in reasoning to arrive at the same result.

Meagher JA and Ball J inferred (and Bret Walker QC for insurers accepted) that, when drafting the policies, insurers were not aware that the Quarantine Act had been repealed and replaced. On that basis, they held that the Court could not have regard to the fact of the repeal as a mistake in considering the parties' intention since it was not one of the surrounding circumstances known to both parties when they made the contract.

Essentially, although inferring that a mistake was made, their Honours held that it was a mistaken assumption as to the status of the Quarantine Act, rather than a mistake in the wording used in the policies. They held that the Court cannot correct an agreement to reflect what might have been agreed had the parties not assumed the Quarantine Act remained in force.

Hammerschlag J suspected a mistake, but did not assume such a mistake had been made. No evidence was led by insurers to confirm the suspicion of a mistake. His Honour noted that if insurers wished to contend that both they and the policyholders shared in a mistake when entering the policy they could have applied to rectify the policy, but had not done so.

While his Honour accepted that it would make more commercial sense to refer to the current Act, he noted that for the Court to intervene the express wording had to be absurd, not just uncommercial. While the distinction between absurdity and uncommerciality may not always be clear, the Court does not substitute its own commercial judgment for that of the parties. Therefore, no correction should be made.

In particular, his Honour noted that:

> *"The insured correctly pointed out that had the Quarantine Act been repealed before policy inception and no other Act had taken its place, there would have been no basis for the words not to have been given their literal meaning. Diseases earlier declared to be quarantinable diseases under the Quarantine Act would have been excluded, as they will be on the literal meaning of those words."*

The most concise explanation for why insurers lost this second argument can be found in the short reasons delivered by Chief Justice Bathurst and President Bell where they held:

> *"The question is one of construction, and of the proper limits and extent to which a contractual document, here the policies of insurance, may be construed in a way which involves a departure from the actual words used by the parties, on their ordinary grammatical meaning. Both Hammerschlag J and Meagher JA and Ball J conclude that orthodox principles of contractual construction are not so flexible as to admit of the insurers' second argument. We are of the same view."*

ICA TEST CASE: FUTURE

Insurers do not have an automatic right to appeal this decision. If they wish to appeal, they must first bring an application for Special Leave to Appeal to the High Court.

Insurers have 28 days to file such an application.

Applications for Special Leave to Appeal are not easy to predict, as they are dependent upon an assessment by the Court of matters such as the public importance of the issue and whether the matter is an appropriate case for restating or clarifying a point of law. Here, a 5-0 judgment of the Court of Appeal based on orthodox principles of contractual interpretation with no contradictory trial decision does not suggest a clear area of doubt or inconsistency in the law that the High Court needs to resolve. On the other hand, this is an issue that has attracted widespread attention of sufficient public importance that the NSW Court of Appeal allowed a leap frog to hear the case urgently without first waiting for a determination by a judge at first instance. A similar approach is being taken in the UK courts. The High Court may therefore grant leave to appeal, but that of course does not mean that the appeal will succeed.

If an application is filed, we would anticipate that the application for leave would likely be heard in the first quarter of 2021 and, if leave is granted, the appeal itself might be heard by the end of FY2021.

OTHER TEST CASES: UPDATE

As noted above, our previous update (here) provided the status of other Australian test cases.

By way of update, a case management hearing was held on 18 November 2020 in relation to the Star City Casino Claim. That matter has been listed for 2 days of hearing on 29-30 April 2021. The Star City Claim is based on the following clause:

> *"....the word "Damage" under Section 2 of this Policy is extended to include loss resulting from or caused by any lawfully constituted authority in connection with or for the purpose of retarding any conflation or other catastrophe"*

The key issues to be decided in the Star case are:

a. Whether the word "loss" is properly construed to mean only physical loss?

b. Whether the term "other catastrophe" is properly construed to include a global pandemic and/or a disease listed under the Biosecurity Act?

c. Whether the exclusion for "disease" in perils exclusion 4(a) (which applies to "*damage occasioned by or happening through... disease*") has any application to a claim under the relevant extension (given it extends the meaning of "Damage").

We believe the outcome of the Star case is likely to provide the most significant guidance on the approach of Australian courts to recovery of Covid-19 related business interruption losses.

It should also be noted that since our last update on the UK test case (here), the 4 day video hearing for the appeal to the UK Supreme Court has begun. Given the urgency with which the leapfrog appeal was scheduled for hearing by the Court, one might reasonably assume a decision will be delivered reasonably quickly, possibly even before Christmas.

WHAT DOES THIS ALL MEAN FOR POLICYHOLDERS?

The judgment in the ICA test case is not the end of the debate in relation to business interruption claims related to Covid-19. Causation issues (was the loss caused by the outbreak within 20km of the premises, or by other circumstances?) and the operation of the "trends and other circumstances" clause will still be big issues in the determination of claims.

But this is the second decision in favour of policyholders which (together with the outcome of the UK FCA test case) shows a preparedness of the Court to consider coverage for Covid-19 related losses based on the wording of the contracts (policies) written, rather than what the insurers say they intended to insure.

Policyholders should continue monitoring the various ongoing decisions and develop / adjust their approach to their claims accordingly. These decisions include:

- the ICA test case (in case of any application for Special Leave to Appeal);
- the other Australian test cases referred to in our previous update (being the Star Casino and Rockment Pty Ltd cases); and
- the appeal decision in the UK FCA test case – which will be very relevant to how Australian courts might approach the issues around causation and the "trends and other circumstances" clause.

ENDNOTES

1. Lord Mustill in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 388.

KEY CONTACTS

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

MARK DARWIN
PARTNER, BRISBANE

+61 7 3258 6632
Mark.Darwin@hsf.com

GUY NARBURGH
SPECIAL COUNSEL, SYDNEY
+61 2 9322 4473
Guy.Narburgh@hsf.com

TRAVIS GOODING
SENIOR ASSOCIATE, BRISBANE
+61 7 3258 6701
travis.gooding@hsf.com

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