

Market Update

Shaping the future of insurance law

5 FEBRUARY 2020

Ducking¹ for cover – will ISR extensions offer protection from the new coronavirus?

AT A GLANCE

- The 2019 Novel Coronavirus has now been declared a Public Health Emergency of International Concern by the World Health Organisation (WHO) – only the sixth time the WHO has made such a declaration.
- An international event of this size and complexity carries a range of insurance risks. While impacts on some lines of insurance remain speculative at this stage, it is possible to consider the potential insurance responses that are likely to impact first party insurance claims lodged with Australian-domiciled insurers.
- In this article, we look at the potential for coverage of financial losses (often referred to as business interruption losses) associated with the new coronavirus, to be available through various optional extensions to the standard ISR wording.

A new threat

The world has been watching the iterative development of the complex domestic, and increasingly international issues associated with the identification and spread of the 2019 Novel Coronavirus (2019-nCoV) (coronavirus), which originated in Wuhan City, Hubei Province in China.

The stakes were raised again on 30 January 2020 when the World Health Organisation officially declared the novel coronavirus to be a public health emergency.

Despite the rapid spread of the virus and escalation of response, it is important for insurers to pause and reflect on how the associated issues and developing layers of activity are likely to impact the insurance market response to financial losses associated with the virus.

An international event of this complexity and magnitude strikes at the heart of a suite of classes of insurance business – most obviously personal lines and travel-related cover. The breadth of policies available across those classes makes any sort of early analysis prophetic only. However, based on our experience with other epidemics and pandemics, it is possible to consider the potential insurance responses to some issues that are likely to impact first party insurance claims lodged with Australian-domiciled insurers.

¹ Or is it a bat...?

History repeating?

The international insurance market has experienced health-related contagion before. For example, Wotton + Kearney worked closely with a wide range of international insurers during the Severe Acute Respiratory Syndrome (SARS) coronavirus epidemic in 2003, the Swine Flu (H1Ni) in 2009 and the Avian Flu A(H7N9) in 2013. We also advised on a significant range of losses associated with the Equine Influenza in 2007.

While all of those incidents have unique features, there are a range of common facts. They were all strains of animal viruses that had a common originating area and were transmitted to humans. They then became notifiable or declared viruses, led to global epidemics or pandemics, and had a flow-on impact across domestic and international commerce. They also caused affected insureds to reach for their insurance policies and start flicking for cover.

Why all of the insurance fuss?

As with many earlier viral events, insureds and brokers are likely to quickly discover the coverage restrictions in standard commercial/ISR policies, which may lead to significant limitations on – or denial of – their financial recovery.

However, the insurance market has matured through a number of global health-related cycles, and policy wordings have evolved to specifically deal with the tricky areas around policy trigger. For example, many of the wordings in play around the SARS-era have been increasingly refined. This has regularised the link between section 1 (Material Damage) and section 2 (Business Interruption) coverage and identified appropriate ways to write bespoke coverage. This evolution should give insureds and insurers dealing with the current pandemic far greater certainty around what is or isn't going to be covered.

The ISR issues and CBI extensions

Cover for the coronavirus across what is known as a standard ISR wording gives rise to the following issues:

- What is the 'trigger' for coverage? All ISR policies are triggered by 'damage', rather than a 'peril'.
- What physical or material damage is needed as a gateway into section 1 cover (for reinstatement or repair), and the attendant section 2 cover for Business Interruption/Time Element?

Most financial loss claims will be directed into the complex series of Section 2 coverage extensions that are loosely captured under the term 'Contingent Business

Interruption' (CBI). CBI coverage is catalysed not by actual damage to insured property but rather by something that is 'deemed' by the policy to be damage. The deeming nature of each of the extension clauses is deliberately different.

The vice in trying to parlay the facts of a pandemic into standard market offerings is that there is superficial attraction to finding the 'peril', rather than the deemed damage. In most cases, the actual 'peril' giving rise to the incident may be excluded in section 1 and might only be written back on a limited basis into a CBI coverage extension. Integrating the 'damage' and the 'peril' under a CBI extension is never as clean as applying a standard section 1 damage trigger.

The matrix below shows how a number of 'perils' guide the operation of the CBI extensions, particularly around Prevention of Access/Premises in the Vicinity, Acts by Civil Authority and Supplier/Customer Extensions. There are no 'standard' clauses in the market, and many bespoke clauses have restrictions knitted into them, such as radius and the level of formality of the civil authority intervention.

CBI extensions that mix these triggers up can often, unintentionally, upset the fabric of the policy. We have seen over the years many attempts to 'widen' CBI coverage extensions, often with the reverse effect. Most CBI covers clearly work on a single peril trigger and combining two perils into one clause can often have a qualifying effect. Additionally, the underlying vice that each extension looks to address is generally very different, which should lead to CBI extensions and any applicable policy sub-limits not being 'stacked' (or at least stackable).

Matrix of potential CBI clauses

The potentially available CBI extensions are generally not included in the base standard ISR wording. Instead, the CBI extensions are typically negotiated as optional extensions (which attract an increased premium) based on the insured's specific needs. The following matrix of potentially available CBI extension clauses is not an exhaustive collection of CBI extensions available in the market. Rather, it is an illustration of some of the more common categories of CBI extensions that will give the reader a flavour of the types of issues that might arise in determining whether cover will be available for business interruption losses in consequence of the coronavirus. Ultimately, the coverage outcome will depend on the specific wording. As you will see, although there are many different CBI extension wordings, there are some consistent coverage themes that emerge in terms of how to approach coverage analysis.

ISR clause	Wording example	Commentary
Typical premises in the vicinity / prevention of access clause	<p><i><u>“Loss as Insured by this Policy resulting from interruption of or interference with the Business in consequence of Damage to property in the vicinity (within 5 kilometres) of the Premises caused by a peril, Damage as a result of which is insured hereunder, which shall prevent or hinder the use thereof or access thereto, whether the Premises or property of the Insured therein shall be Damaged or not, shall be deemed to be loss resulting from Damage to property used by the Insured at the Premises.”</u></i></p>	<p>The traditional Prevention of Access (POA) CBI cover requires a classic ‘damage’ trigger to property caused by some peril within a specified radius of the risk situation. For example, storm damage to a bridge prevents access to nearby insured manufacturing plant, resulting in a s.2 loss.</p> <p>We anticipate POA endorsements worded this way will have limited ‘work’ to do where there is no triggering ‘damage’ to property in the vicinity.</p> <p>POA cover is usually sub-limited, if available at all.</p>
One example of a closure by order of a public authority clause	<p><i><u>“Loss as insured by this policy resulting from interruption of or interference with the Business directly or indirectly arising from closure or evacuation of the whole or part of the Premises or other premises in the vicinity of the Premises by order of a competent public authority directly or indirectly arising from infectious or contagious human disease occurring at such premises...shall be deemed to be loss resulting from damage to property used by the Insured at the Premises.</u></i></p>	<p>The cover provided by this CBI extension is analogous to the cover provided under the prevention of access clause, except here the prevention of access is the result of a closure/evacuation order by a public authority, rather than by damage.</p> <p>Note, however, that cover is triggered only where the closure order arises from an infectious or contagious disease occurring at or in the vicinity of the premises.</p> <p>For an Insured with this type of wording, Section 2 cover for losses due to the coronavirus could potentially be triggered if the circumstances meet the description of the required closure order.</p> <p>Cover under this extension is usually sub-limited.</p>
Alternative example of a closure by public authority clause	<p><i><u>“Loss as insured by this Policy resulting from interruption of or interference with the Business directly arising from an occurrence or outbreak at the Insured’s premises only and limited to:</u></i></p> <p><i><u>closure or evacuation of the whole or part of the Premises by order of any Government, Local Government or other Statutory Authority consequent upon:</u></i></p> <p><i>1. (a) <u>any occurrence of a Notifiable Disease (as defined below) at the Premises,...</u></i></p> <p><i><u>shall be deemed to be loss resulting from Damage to the property used by the Insured at the Premises.</u></i></p> <p><i><u>Notifiable Disease shall mean illness sustained by any person resulting from an occurrence of a human infectious or human contagious disease which the competent local authority has stipulated shall be notified to them, with the exception of any occurrence, whether directly or indirectly, of Acquired Immune</u></i></p>	<p>There are several key elements to trigger this type of endorsement, including:</p> <ul style="list-style-type: none"> • loss resulting from interruption/interference • arising from occurrence/outbreak of ‘notifiable disease’ <u>at the insured’s premises only</u>, and • <u>an order of government or statutory authority for closure or evacuation of the premises because of presence of a ‘notifiable disease’ (emphasis added)</u> <p>When broken-down, the endorsement is quite restrictive. It would first require presence of the coronavirus at an insured’s premises (not just in proximity), in addition to a closure or evacuation order from “Government, Local Government or other Statutory Authority”. That would not include the WHO declaration as the order needs to be made domestically and specifically to the premises.</p> <p>The definition of ‘notifiable disease’ in some policies requires analysis, including any ‘carve-outs’. Some clauses go on to except other diseases (like AIDS/SARS) declared to be a</p>

ISR clause	Wording example	Commentary
	<i>Deficiency Syndrome (AIDS) or an AIDS related condition, Severe Acute Respiratory Syndrome (SARS), any mutation of H5N1 that manifests itself as a human infectious or human contagious disease which are all specifically excluded hereunder."</i>	quarantinable disease under the <i>Quarantine Act 1908</i> and subsequent amendments. Such clauses require a close read in view of repeal of the <i>Quarantine Act</i> and the recent Department of Health update providing that "Human coronavirus with pandemic potential is now a Listed Human Disease under the <i>Biosecurity Act 2015</i> " ² . So coronavirus might qualify as a 'notifiable disease' on the example definition clause, but potentially not for other variants. Again, this endorsement is usually sub-limited.
Typical suppliers/customers' premises clause	<i>"Any loss resulting from interruption of or interference with the Business in consequence of Damage to property at the premises of any supplier or customer (or in the vicinity of such premises which prevents or hinders the use of or access to such premises), shall be deemed to be Damage to property used by the Insured at the Premises."</i>	Like the POA clause discussed above, this clause also has a traditional 'damage' trigger to property, albeit at an insured's customer/supplier's premises. This clause variant adds a 'premises in the vicinity/POA-type' extension to customer/supplier premises. Ultimately, the same kinds of issues arise in the application of this clause because of the property damage trigger, as with the POA clause discussed above. Again, this endorsement is usually sub-limited.

The effect of WHO's declaration

On 30 January 2020, the World Health Organisation officially declared the novel coronavirus as a public health emergency. Officially, it is labelled as a Public Health Emergency of International Concern (PHEIC).

According to the *New York Times*³, this is only the sixth time the World Health Organisation has declared a PHEIC since it was established in 2005. It did so for the Swine Flu pandemic in 2009, a polio outbreak in 2014, an Ebola outbreak in 2014, the Zika virus outbreak in 2016 and an Ebola outbreak in 2019.

While the PHEIC has been declared, and member states (including Australia) are obliged to comply with the Regulations, the focus is around coordinating an international response from countries to address matters like travel, trade, quarantine, screening and treatment.

The WHO's PHEIC declaration alone is unlikely to have a direct 'triggering' impact on property policies that contain conventional CBI clauses. While each clause will need to be considered on its own merits, the relevant public authority order is usually domestic, not the WHO. Local governments and authorities are likely to exercise their own discretion on whether or not to close down a business and are not bound to strictly follow the WHO's declaration.



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²<https://www.health.gov.au/ministers/the-hon-greg-hunt-mp/media/update-on-novel-coronavirus-in-australia>

³ <https://www.nytimes.com/2020/01/30/health/coronavirus-world-health-organization.html>

The way forward for insurers

The market challenge with all events of this complexity is the lack of an obvious answer within the CBI coverage extensions to a 'standard' set of facts. In many events of this type, the vast majority of claims are unlikely to fall neatly within the four walls of a CBI extension.

The same can be said of many of the catastrophic losses that have followed the most recent Australian bushfire season, where many businesses are likely to have suffered significant business interruption losses in circumstances where they have not themselves suffered any damage to trigger section 2 cover. Anecdotally, we understand that many insurers are under enormous pressure to consider business interruption claims that do not neatly fall within the precise terms of the available CBI extensions.

It remains to be seen whether similar pressures will emerge in respect of the coronavirus. What is certain, however, is that for Australian insurers already grappling with a catastrophic months-long bushfire season, the sweeping panic caused by the new strain of coronavirus could not have come at a worse time.

Need to know more?

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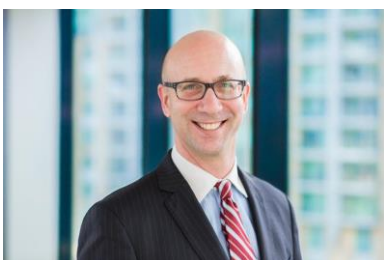


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