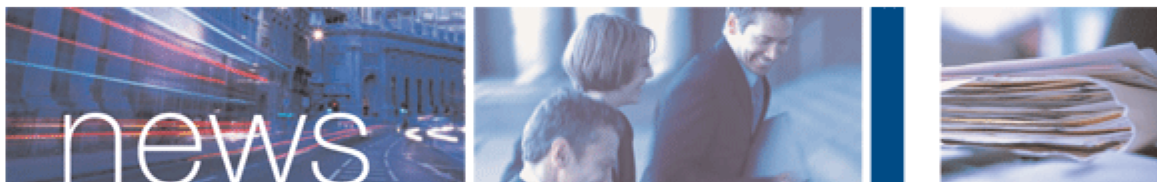

gadens lawyers

july 2011

corporate risk and insurance update

Sparking a divide in defining 'damage' in business interruption claims? *Mainstream Aquaculture Pty Ltd v Calliden Insurance Ltd* [2011] VSC 286

By Jessica Kinny and Ray Giblett of Gadens Lawyers, Sydney

The concept of 'damage' is fundamental to business interruption insurance because without it there is often no cover. A broad approach to what constitutes 'damage' can therefore have a significant impact on the scope of such policies.

The Victorian Supreme Court has generally adopted a wide interpretation of the term 'damage'. In a recent decision 'damage' was held to include a tripped fuse located on the site of another business that stopped electricity from being supplied to the plaintiff's business, causing loss.

Interestingly, a design feature of the fuse was to 'trip' (i.e. cause damage to itself) to prevent damage from being done to the electric circuit it was attached to. It seems that, in Victoria at least, property may be considered 'damaged' if the object's use has been altered by an incident that has made that object less useful or valuable, regardless if damage was a function of its use.

Is this an ordinary result of a common sense approach to business interruption claims, or has the case sparked a divide between how these claims are addressed in Victoria and New South Wales?

The day the fish went 'belly-up'

The plaintiff, Mainstream Aquaculture Pty Ltd, ran a commercial fish breeding business. On 26 October 2008, the property that the business operated in experienced a loss of electrical power because an unusual surge of electricity at a power station of an electricity provider, Powercor, caused a fuse to be blown. This was a design feature of the fuse to protect the electric circuit. The plaintiff's back-up electricity generator failed and as a result all the fish on the breeding site died.

The plaintiff held two insurance policies: property damage insurance with CGU Insurance Ltd and business interruption insurance with Calliden Insurance Ltd (the **Policy**). The plaintiff lodged a claim under the second policy which was rejected.

To determine whether the event – the blown fuse – triggered the business interruption cover, the presiding judge, Justice Croft, considered whether the fuse was 'property' within the Policy terms, whether the fuse was 'damaged' within the Policy terms and whether the damage to the fuse was a proximate cause of the interruption to the business. Aside from an expert evidence issue (as the relevant fuse had been discarded), the key question to be determined was the meaning of the term 'damage' (undefined in the Policy).

A short-circuited policy?

Justice Croft prefaced his finding with the general principle that an insurance policy is to be given a 'businesslike interpretation', having regard to the language used by the parties, the commercial circumstances the policy covers and the objects it is intended to secure[1].

The 'Additional Benefits' section of the Policy included '*Failure of Supply from Public Utilities*' as a covered event, including specifically '*any installation or Electricity Station or Sub-station*'. Although the term 'property' was not defined, his Honour held that the fuse was capable of constituting 'property' within the terms of the Policy. As the 'Additional Benefits' section of the Policy extended cover for '*failure of Supply from Public Utilities*' to include loss or damage to '*any installation or Electricity Station or Sub-station*', the assets of Powercor were treated as the plaintiff's buildings. It was common ground that the Policy extended to insure against damage to the plaintiff's property that causes an interruption or interference with the business.

For the policy to be enlivened, the property (i.e. the fuse) also had to be damaged. The defendant argued that the fuse could not be said to be damaged by being 'tripped' because it was designed to blow when an unusually high level of electric current passed through it for the purpose of closing off the circuit from this electric current. The fuse blowing was in fact an intended function of the property, not damage.

The plaintiff argued that: first, a fuse blowing in itself is damage; and second, the connections to the fuse were loose which contributed to the overheating of the fuse necessary to cause it to 'trip', contributing to the blowing of the fuse which caused the business interruption to the plaintiff.

His Honour agreed with the argument of the plaintiff, and found that the fuse was most likely damaged prior to the power failure event and in any case was damaged or further damaged on the occurrence of the power surge.

What is 'damage'?

Croft J found that the word 'damage' in the Policy should not have a meaning applied to it beyond its ordinary dictionary meaning: *the defining characteristic of which seems to be some form of impairment, harm, hurt, or injury*[2].

Based on the various authorities submitted by the plaintiff as to how the meaning of 'damage' is to be construed[3], his Honour held that: *a rupture (or 'tripped') fuse is still 'damaged', despite the fact that it is designed to operate in this manner (that is, to rupture or be 'tripped') to stop a potentially damaging overload of current*[4]. Based on this interpretation, Justice Croft ruled that the business interruption was suffered from loss of electrical power, which was caused by the damaged fuse.

How the exclusions were wired

An exclusion in the Policy also provided: *We [the defendant insurer] will not pay for: 1. Interruptions of interference to your Business arising from loss or damage caused by (unless otherwise stated): a. … b. Mechanical, Electrical or Electronic Breakdowns or Breakages*[5]*.*

The defendant submitted that the '*Exclusions*' provision of the Policy was activated on two alternate grounds. The first ground was that the failure of the back-up generator to provide alternative power to the premises constituted an electrical breakdown. The second ground was that the damage to the fuse constituted an electronic breakdown or breakage within the meaning of the exclusion clause[6].

Justice Croft found that the exclusion did not apply, rejecting both grounds as an uncommercial reading of the Policy. In answer to the first ground, his Honour did not consider the existence or non-operation of the generator to be relevant to the exclusion. His Honour pointed out that the insured was not required under the Policy to have a back up generator, and could not be placed in a worse position for taking the precaution than if they did not install it[7].

In answer to the second ground, his Honour did not categorise the damage to the fuse as an electronic breakdown within the meaning of the exclusion. To apply the exclusion as contended would defeat all claims for insurance pursuant to a '*Failure of Supply*' which required relevant property damage as a precondition to an insurance payment[8].

Will this 'damage' the position of business interruption insurers?

Justice Croft has given a broad interpretation to the meaning of 'damage' in the context of a business interruption insurance policy. His Honour's interpretation of the term seems to follow closely the definition in *Switzerland Insurance Australia Ltd v Dundean Distributors Pty Ltd*[9]; that there is property damage if that property: *is interfered with in such a way as to render it less useful or valuable and in consequence time and money*

are required to restore that use or value…'[10]. Such an interpretation is very wide, but not unusual.

When considering how this affects New South Wales claims, it should be remembered that the plaintiff in this matter referenced cases in Victoria, Tasmania, South Australia and Queensland that supported similar interpretations of the meaning of 'damage'[11].

There is also authority in New South Wales supporting such a finding. In 2004 the New South Wales Court of Appeal also considered a policy that provided cover against physical damage to property insured and found that the damage extended to: *… physical alteration or change that impairs the value or usefulness of the thing said to have been damaged*[12].

However, this should be contrasted with the earlier New South Wales Court of Appeal finding in *Transfield Constructions Pty Ltd v GIO Australia Holdings Pty Ltd*[13]. In that case, the insured had contracted to build grain silos, and insured the works against '*physical loss or damage'*. Because of a defect in the silo screens, grain was being blocked and production halted until they were fixed. To the question whether this blockage constituted 'physical loss or damage', Meagher JA, with whom Clarke and Sheller JJA concurred, held that: *loss of usefulness might in some contexts amount to damage, though even that is not beyond dispute, but in my view it cannot amount to physical damage. Functional inutility is different from physical damage.*

The lesson to be learned by insurers in New South Wales, indeed all jurisdictions, is that an ordinary reading of an insurance policy – where words are given a 'businesslike interpretation' – can produce unexpected results. Insurers would be well-advised to define key terms such as 'damage' in business interruption policies, although this should not be the only precaution that insurers take. It is important to consider what a businesslike interpretation of the words and phrases in the policy must be when considering the range of loss scenarios that might trigger indemnity for a business interruption claim.

---

[1] Croft J at 29, making reference to the judgment of Gleeson CJ in *McCann v Switzerland Insurance* (2000) 203 CLR 579 at 589.
[2] [2011] VSC 286 at 38
[3] *Switzerland Insurance Australia Ltd v Dundean Distributors Pty Ltd* [1998] 4 VR 692 at p.714 per Phillips JA; *Ranicar v Frigmobile Pty Ltd* [1983] Tas R 113 at 116; *R v Fisher* (1865) 1 LRCCR 7; *R v Tacey* (1821) 168 ER 893; *King v Lees* (1948) 65 TLR 21; *Samuels v Stubbs* (1972) 4 SASR 200; *R v Zischke* [1983] 1 Qd R 240.
[4] [2011] VSC 286 at 40
[5] [2011] VSC 286 at 44
[6] [2011] VSC 286 at 45
[7] [2011] VSC 286 at 46
[8] [2011] VSC 286 at 47
[9] [1998] 4 VR 692
[10] [1998] 4 VR 692 per Phillips JA at p.714
[11] [1998] 4 VR 692 at 39
[12] *AXA Global Risks (UK) Ltd v Haskins Contractors Pty Ltd* [2004] 13 ANZ Ins Cas 77401 per Mason P at [41].
[13] [1997] 9 ANZ Ins Cas 61-336

This report does not comprise legal advice and neither Gadens Lawyers nor the authors accept any responsibility for it.