UNDERSTANDING THE ISR POLICY

A Comprehensive Guide on the cover afforded by the Industrial Special Risks Policy for Insurance Brokers and Advisers, Underwriters and Claims Officers, Loss Adjusters, and Risk Managers

Volume 3: Aids to Understanding

This volume contains
A Review of the Rules for Document Interpretation and Drafting
A Study of Proximate Cause with Special Reference to How it Applies to Industrial Special Risks Policies
A Schedule of Differences between the Mark IV and V Policies
Definitions of Terms used in ISR Policies
Table of Statutes & Regulations
Table of Cases
Bibliography

Allan Manning
To my beautiful daughter, Susan
A constant source of love, pride and joy.

“Writing about an idea frees me of it. Thinking about it is a circle of repetitions.”
Mason Cooley

Other titles by this Author
Understanding the ISR Policy: A Comprehensive Guide - Volume 1: The Mark IV
Business Interruption Insurance & Claims: A Practical Guide
Fidelity, Theft & Money Insurance & Claims: A Practical Guide
The Closure of the Bougainville Copper Mine: Anatomy of a Major Claim
It Will Never Happen to Me! The Strategic Management of Crises in Business

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I am honoured and privileged to be asked to write the foreword to this latest book by Dr Allan Manning. I was even more delighted when I dipped into what is Volume 3 of a comprehensive commentary on the Industrial Special Risks Policy, now used throughout the insurance industry in Australia.

Business people demand certainty from their professional providers, whether bankers, lawyers, accountants or insurers. Older members of the insurance industry may look back wistfully to the days when Tariff wordings were used by many insurers, and provided a form of common and universal language to cover many risks. The advent of the ISR has produced a similar common element for insurers and their clients, but because of the complexity of modern life and the variety and increasing numbers of risks which we have seen evolve over the last 50 years, an informative commentary and advice concerning the ISR will fulfil a very real need in the industry.

This volume provides a real understanding to the ISR policy, beginning with the very helpful advice concerning the drafting and interpretation of the policy, and a detailed commentary concerning the construction of the policy.

It is followed by a long overdue discussion of proximate cause and related issues, all of which for too long have been regarded by too many people in the industry as dark, uncharted waters. Dr Manning has provided clear and uncomplicated comments and advice, and has clearly stated where the law is uncertain, ambiguous or plain contradictory. This includes a discussion of exclusions and their relationship to the problems of proximity.

There is a bonus for brokers with a detailed schedule of differences between the Mark IV and Mark V wordings. Underwriters have been provided with several pages of definitions, which will also be of assistance to other members of the industry. Lawyers are provided with a crib of cases, with their subject matter detailed in a simple and clear fashion. There is a table of statutes and regulations, a table of abbreviations and, finally a most helpful, bibliography and an index, which many such guides lack.

I am pleased to recommend this book to all members of the insurance industry and their advisers, whether they be loss adjusters, risk managers or claims consultants. All of us will find this book invaluable when considering the Industrial Special Risks Policy, whether we are considering providing cover, the extent of cover, the response to a claim, or the investigation of a claim.

David Letcher
Referee
Brokers Disputes Facility Ltd
Senior Partner, Norris Coates, Lawyers

Melbourne, 16 November 2005
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INTRODUCTION

“Give a man a fish, and you feed him for a day.
Teach a man to fish, and you feed him for a lifetime.”
Chinese Proverb

It was this ancient Chinese proverb that initially prompted me to prepare this supplementary volume as an aid to understanding the Industrial Special Risks (“ISR”) policies.

Another influence was Jacob Bronowski’s 1973 study of the history of science titled ‘The Ascent of Man’. In this book, the point was made that you can observe an artist or sculptor during the creative process and thereby gain understanding on how it all came together. However, with the typical textbook or research paper, a reader only views the end result, that is, the author’s conclusion. This posed an interesting challenge that I decided to take up. I have spent over 1,200 hours researching the content and then writing this Guide. I believe that providing you with at least some of the thought process will be beneficial to your understanding.

In the earlier two volumes, I have attempted to provide the basis of my opinion to assist the reader in forming their own conclusion. I have taken this a step further, with the decision to add a third volume. I initially had manuscript ISR wordings in mind for this third volume, but have since extended this to include additional tools, as I believe this will assist in your analysis of any contract of insurance.

Continuing with this approach, I have researched and prepared papers in the following important areas. The first, in Part A, is titled ‘A Review of the Rules for Document Interpretation & Drafting’. This provides commentary on the rules that the Courts use to interpret an insurance policy which, as you will appreciate, is a form of legal contract.

Secondly, I felt a separate detailed examination of the doctrine of proximate cause would be beneficial to determine whether a particular loss falls within the scope of the policy. The examination I have prepared not only considers the rules applied by the Court, but also the equally important area of onus of proof. This paper, titled ‘A Study of Proximate Cause with Special Reference to How it Applies to Industrial Special Risks Policies’, can be found in Part B.

As I reviewed the various clauses and sub-clauses of the policies in the preparation of Volumes 1 and 2, I found over 200 differences between the Advisory and Modified versions of the Mark IV and Mark V policies. Part C is a summary, in tabular form, of all but the most minor differences between each wording. With the industry using at least three of these versions of the industry ISR policy, plus a myriad of manuscripted wordings on a day-to-day basis, I would argue that some attempt needs to be made to standardise the cover in one policy, which not only picks up the differences between the existing policies, but also addresses the significant failings in the current versions. If there is any interest in this concept, I would be happy, using the research contained in this Guide, to produce a first draft of a Mark VI for industry comment. I do not suggest a committee be formed in the first instance, as I fear that this is the root cause of many of the problems in the earlier versions. With a draft before them, perhaps with some commentary, all interested stakeholders could offer comment and constructive criticism on a new wording, from which the final version could be produced. Feedback on this suggestion would be very much appreciated.

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During development of this Guide, I occasionally had need to refer to dictionaries for definitions to assist with research into the meaning of words or phrases contained in the policies. Even though Lord Coleridge said in *R v Peters* (1886)\(^2\):

> "I am quite aware that dictionaries are not to be taken as authoritative exponents of the meaning of words used in the Acts of Parliament, but it is a well-known rule of courts of law that words should be taken to be used in their ordinary sense and we are therefore sent for instruction to these books."

I felt that it was important that these definitions be recorded in a single location as a quick reference. The definitions I have used derive from a number of sources, however, most were extracted from the *Macquarie Dictionary*\(^3\). A full list of definitions used in the earlier volumes can be found at Part D.

I have also referred to a number of court cases relevant to areas of the policy discussed, and associated with a particular sub-clause. Cases were also drawn upon when I was reviewing the rules of contract interpretation and for the paper on proximate cause. I am not a lawyer, and this book is not intended to be a legal reference book. There are many excellent references, and I have included several in the bibliography. The practitioner should seek legal advice whenever they are in doubt on a point of law or when in dispute that may result in litigation. While I have attempted to provide some initial thoughts on various aspects, I stress that this should not be used in lieu of a detailed analysis by a legal advisor specialising in insurance law. A full list of the cases to which I have referred is set out in Part E. I wish to express my sincere appreciation to Ms Celandine Letcher for her assistance in double-checking these cases and, in some cases, locating the full citation on decisions, particularly those that I only remembered by some obscure name from my student days. I know this took Celandine many hours of careful research but which greatly adds to the value of this Guide.

**Part F** similarly provides a full list of all the statutes and regulations cited in the Guide.

Insurance, like most industries, has its jargon and abbreviations. I provide a table of abbreviations and their meanings in Part G.

In a letter to Robert Hooke on 15 February 1675, Sir Isaac Newton wrote, *"If I have seen further it is by standing on the shoulders of giants"*. I am, by no stretch of the imagination, a Newton, but I know exactly what he meant by this line. During the course of preparing this Guide, I have referred to many excellent books, papers, articles and judgements. While I have provided reference to these throughout the Guide, a full bibliography is included at Part H.

A Guide of this type is dependent on a very detailed index. To avoid confusion between the volumes, an index is provided at the end of each volume of the Guide, covering the content in that volume only.

I would be extremely pleased to receive your feedback regarding the relevance, ease of understanding and usefulness of the material contained herein, and any suggestions for improvement that you may have. You may contact me via email: allan.manning@LMIGroup.com. It is through such feedback that this Guide will continue to grow with each new edition.

A work of this size, which is in excess of 550,000 words, does not just happen. I had great support from a number of people. Sincere thanks goes to many of my colleagues at the LMI Group, who have offered valuable comment based on their years of experience. They have also provided ongoing encouragement and other practical help. Those involved include: Terry Onnot, Angus Stewart, Bruce Avenell, Les Thorpe, Mike Quinlan, Thomas Korab, Gordon Lum, Helen Manning, Ian Fry, Phil Burn, Andrew Korab, and Steven Manning.

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\(^2\) *R v Peters* (1886) 16 Cox CC 36; (1886) 16 QBD 636.

Valuable assistance was also provided by Victoria University and the Graduate School in particular, as well as Janet Lambrou and Josh Pederick. For this help, I am most grateful.

Special thanks also goes to David Goodlad, Max Salveson, Adam Matteson, Robert Riddoch, Jim Hatz, Rob Willsher and Dale Coombes - all industry experts of whom I have the highest regard, and who offered comment or debate on many points. Any views that I express in this book are not necessarily shared by all of those listed.

Finally, I wish to thank Wendy Hunter of Secretaries on the Move, for her assistance in the design and presentation of the text.

Allan Manning
Melbourne, 27 November 2005

**Limitations & Disclaimers** This text has been prepared as a guide only and is not intended to be an exhaustive or definitive review of the policies of insurance or law referred to herein. Whilst great care has been taken in the preparation of the Guide, it should not be used or relied upon as a substitute for professional legal or business advice, nor as a basis for formulating any commercial or legal decision. Special care needs to be taken when reading the Guide as no two policies of insurance or factual circumstances are alike, and the specific policy wording needs to be carefully read and understood in full, having regard to all the circumstances.

Throughout this Guide the names of fictitious insurers, companies and individuals have been used by way of example to illustrate a particular point or points. Any resemblance to any company, insurer or individual, past, present or future is completely fortuitous, coincidental and unintentional unless expressly stated to the contrary.

The summaries and references to judicial decisions used in this Guide do not reflect the view or opinion of the author or publisher as to the correctness or otherwise of any such judicial decision or pronouncement of law.

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The above limitations and disclaimers extend not only to the text in this guide, but also to any related information provided in writing or verbally (for example, responses to queries regarding the information in the Guide). If any provision of this section headed “Limitations & Disclaimers” is void, avoided, illegal or unenforceable, the provision is to be read down (and applied as read down) to the extent necessary to prevent it from being void, avoided, illegal or unenforceable. However, if that cannot be done, the provision is to be severed and the rest of this section is to be given full effect with any necessary modifications resulting from the severance of the provision.
CHAPTER 8 - PROXIMATE CAUSE IN RELATION TO THE ISR POLICY: SECTION 2 INTERRUPTION INSURANCE

The actual wordings of the insuring clauses of the various Mark IV and Mark V policies are reproduced below.

Mark IV Advisory
SECTION 2 - CONSEQUENTIAL LOSS

“In the event of any building or any other property or any part thereof used by the Insured at the Premises for the purpose of the Business being physically lost, destroyed or damaged by any cause or event not hereinafter excluded (loss, destruction or damage so caused being hereinafter termed “Damage”) and the Business carried on by the Insured being in consequence thereof interrupted or interfered with, the Insurer(s) will, subject to the provisions of this Policy including the limitation on the Insurer(s) liability, pay to the Insured the amount of loss resulting from such interruption or interference in accordance with the applicable Basis of Settlement.”

Mark IV Modified
SECTION 2 - CONSEQUENTIAL LOSS

With the exception of the inclusion of the words “during the period of insurance” at the end of the third line, the wording is the same as the Mark IV Advisory wording.

“In the event of any building or any other property or any part thereof used by the Insured at the Premises for the purpose of the Business being physically lost, destroyed or damaged during the period of insurance by any cause or event not hereinafter excluded (loss, destruction or damage so caused being hereinafter termed “Damage”) and the Business carried on by the Insured being in consequence thereof interrupted or interfered with, the Insurer(s) will, subject to the provisions of this Policy including the limitation on the Insurer(s) liability, pay to the Insured the amount of loss resulting from such interruption or interference in accordance with the applicable Basis of Settlement.”

Mark V Advisory & Mark V Modified

“9. EXTENT OF COVER

9.1 Provided that the Insured has paid or agreed to pay the premium stated in the Schedule, 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 caused by Damage occurring during the Period of Insurance to:…”
In all but the Mark IV Advisory wording, the trigger for a claim under Section 2 – Interruption Insurance is “Damage” occurring during the “Period of Insurance”. Not only is “Damage” the trigger, but it provides a crucial definition of, and limit to, the scope of the cover provided by Section 2. What this means is that the policy does cover all losses that flow from a circumstance that is insured under the policy. It only covers those losses, which flow from “Damage”. In the case of the Mark V wordings, this is defined in Sub-Clause 1.15, and described in Sub-Clauses 9.1.1 to 9.1.7.

Before continuing, it is appropriate that we refresh our understanding of the term “Damage” as defined in the policy. In the Mark IV wording, it is defined in the insuring clause under the heading Indemnity as “physical loss, destruction or damage”. While the order of the words has been changed, the meaning is the same under the Mark V.

“1.15 DAMAGE (with Damaged having a corresponding meaning) means physical loss
damage or destruction.”

I have provided lengthy commentary on this short two-line definition, which you can find in Part B, Chapter 1, Section 1.15.

When a potential claim arises under Section 2 of the policy, it is necessary to identify the loss, which is caused by the damage as distinct from the loss caused by other factors (including damage), which falls outside the scope of the cover (excluded property), and losses from the cause itself rather than the damage. An example of losses arising from the cause as opposed to the Damage can be found in the case of McMahon’s Tavern Pty Ltd v Suncorp Metway Insurance Ltd (2004)159. In this case, the Insured operated a tavern. In the early hours of the morning on 21 February 1999, a group of customers who had been asked to leave, returned and confronted customers and staff. Some damage was occasioned to windows and cars in the car park during the ‘incident’. The damage was quickly repaired (around 2 hours) and the business reopened. However, the Insured claimed that a drop in turnover resulted in a loss of gross profit. The Insurer argued that the drop in turnover and gross profit was due to the disturbance and not to the resulting damage.

Justice Anderson provided the leading judgment of the Court of Appeal, and found in favour of the Insurer. Justice Anderson stated that, in his view, “The clear purpose of the business interruption clause was to indemnify for monetary loss arising as a consequence of physical damage to the premises, not to the Tavern’s reputation”. The other two judges, Justices Besanko and Duggan, agreed with the decision of Justice Anderson. Justice Besanko added that while there were two ways to read the [insuring] clause, the court should consider which of those readings is more logical in the context of the insurance contract as a whole. His view was that it is only when both interpretations are equally open to a logical reading of the contract as a whole that the court should rely on the contra proferentum rule.

158 This is not the case in the Mark IV Advisory wording, as the words “During the period of insurance” do not appear in the insuring clause. The only trigger is therefore interruption following “damage”.


160 Refer Part A for an explanation of the contra proferentum rule and the other rules of document drafting and interpretation.

Understanding the ISR Policy
Volume 3: Aids to Understanding

Part B - A Study of Proximate Cause

The judges in this case and, in fact, it is the case with industry practice, did not separate concurrent losses. If we continue to use the McMahons Tavern Case as an example, during the first few hours until the damage was repaired, interruption was being effected by two causes, both arising out of the one circumstance. Part of the interruption loss was due to damage to Insured Property from a circumstance, which was not excluded. Clearly, it was unsafe for staff and patrons to be in an area with broken glass and, similarly, it would have been too dangerous to have people in a bar area when glaziers were re-glazing the broken panes. During this same time period, there was no doubt interruption as customers and potential customers were frightened off by the threat of injury or the change in mood brought about by the commotion. As was seen, if there had been no damage, there would have been no claim at all under the interruption insurance section of the policy. However, during the period that the business sustained interruption due to the Damage to Insured Property, and which therefore gave rise to a valid claim, the Insured is entitled to the full loss sustained as a result of the entire interruption, despite there being concurrent interruption to that insured due to other circumstances that, if acting by itself, would not be insured. Once the interruption due to Damage to Insured Property would normally have been expected to end (ie. if there were no other causes acting on the business causing a disruption), the cover is at an end. As with the McMahons Tavern Case, the ongoing disruption resulting from an uninsured cause is not covered by the interruption policy.

This approach follows one of the basic rules of Proximate Cause on Property losses, which states that where an insured and an uninsured peril act together, the Insured is entitled to indemnity in full. This rule was confirmed in JJ Lloyd Instruments Ltd v Northern Star Insurance Co Ltd (The Miss Jay Jay) (1987). Here, Lord Justice Slade stated:

“However, since the insurance policy contains no relevant exception...different principles apply. The legal position in such a case is stated thus in Halsbury’s Law of England (4th Edition, Volume 25, paragraph 18) which relates to marine insurance policies:

'It seems that there may be more than one proximate (in the sense of effective or direct) cause of loss. If one of these causes is insured against under the policy and none of the others is expressly excluded from the policy, the assured will be entitled to recover.’

'No authority has been cited that leads me to suppose that this passage incorrectly states the relevant laws relating to marine insurance policies, and in my judgement, it incorporates the principle applicable to the present case.”

While this was a marine case, the rules of proximate cause are the same for fire and general insurance. For example, in City Centre Cold Store Pty Ltd v Preservatrice Skandia Insurance Ltd, the Supreme Court of New South Wales accepted that there may be two or more “dominate”, “effective” and thus proximate causes, and that it is sufficient [for the Insured to be entitled to an indemnity] if one of those proximate causes is an insured peril.

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163 Ibid.
164 This does not apply in the case of an excepted peril, refer Wayne Tank and Pump Co Ltd v Employers’ Liability Assurance Core Ltd (1974) 1 QB 57.
This can become more complicated where the interruption is extended due to subsequent factors, which delay the resumption of normal business. For example:

- Bad weather delays the rebuilding of a damaged building.
- After months of saying he will rebuild, the landlord has decided not to.
- A customer decides that he can no longer afford to have a single supplier policy as part of an improved risk management plan based on the issues brought about by the Insured’s loss, and takes half his business away permanently.

Hickmott (1990)\(^{168}\) states that in the United Kingdom, Insurers have agreed that interruption insurance provides financial loss indemnity on the basis of:

“Allowing within the cover the aggravation of an insured loss, whether directly or indirectly but subject to:

(i) That it would not otherwise have occurred but for the original damage, and
(ii) It arises from matters beyond the Insured's control.”

(Hickmott\(^{169}\), 1990, p.18)

The Australian decision of *PMB Australia Limited v MMI General Insurance Limited* (2002)\(^{170}\) followed this approach. The court found that once the effects of the initial damage were overcome and new unrelated factors continued to affect the business, the Insurer’s liability for compensation was at an end.

It is important to keep in mind that the definition of The Insured can introduce further business operations of a group, within the policy terms, which may have sustained interruption due to Damage at another situation\(^{171}\). The definition of property insured by Section 1 of the ISR policy can have a direct effect on the extent and nature of cover afforded by Section 2 – Interruption Insurance\(^{172}\). Additional cover provided within the policy and Endorsements to the policy may extend the cover beyond damage to Insured Property, eg. Public Utilities (Sub-Clause 9.1.3 in the Mark V).

To recap on what we have learnt from this clause so far, is that there are three separate areas that need to be examined when considering a business interruption claim:

(a) The proximate cause aspect relevant to the event of the peril and the damage therefrom. Hickmott\(^{173}\) (1990) terms this the ‘Proximate Peril’. In keeping with the more modern Mark V wording, I recommend a move to the term ‘Proximate Circumstance’.

(b) The extent that the interruption arises out of the terms of the contract of insurance. This, Hickmott\(^{174}\) (1990) terms the ‘Interruption Causation’.

(c) The assessment of the financial loss as insured by the policy and arising from the interruption, which is insured. Hickmott\(^{175}\) (1990) terms this, the ‘Quantum Calculation’.

We have a quick look at each in the following chapters.


\(^{169}\) Ibid.


\(^{172}\) Ibid.

\(^{173}\) Ibid p.2.

\(^{174}\) Ibid.

\(^{175}\) Ibid p2.
THE AUTHOR

Professional Qualifications

Doctor of Business Administration
Bachelor of Commerce
Master of Business Administration
Fellow Certified Practising Accountant
Fellow Aust & NZ Institute of Insurance & Finance
Fellow Chartered Insurance Institute (UK)
Fellow Chartered Loss Adjuster
Fellow Chartered Institute of Loss Adjusters (UK)
Chartered Insurance Practitioner (UK)
FUEDI European Loss Adjusting Expert

Professional Experience

After 11 years experience with General Accident Insurance, Allan joined Robins MBS Loss Adjusters in 1981. In 1987, he transferred to Papua New Guinea, as Managing Director. During this time, Allan handled one of Australia’s largest claims, which surrounded the closure of the Bougainville Copper mine. Allan returned to Australia in 1990 as State Manager, Western Australia and, in 1991, was appointed Regional Manager for the Southern Region, as well as head of GAB Robins’ large claims team.

Dr Manning founded the LMI Group in 1999, a firm dedicated to providing a high level of customer service and technical expertise in both pre- and post-loss insurance services. These include loss management, risk assessment and technical advice to the general insurance and business communities. He developed Policycomparison.com, an online comparator of general insurance products, now widely used in Australia and New Zealand. His most recent brainchild is PolicyCoach, a web-based expert system to aid in the preparation of ISR and Marine Cargo policies, including industry-specific endorsements. Naturally, this system also provides comprehensive online training.

For 35 years, Allan has managed large and complex losses, involving major property, business interruption including advanced consequential loss, fidelity, construction and liability throughout Australia, Asia Pacific, Europe and North America. Assignments have been completed for multi-national and government organisations, as well as small and medium businesses. He particularly enjoys the challenge of assisting companies to return to normal trading after a major crisis. His interest in the survival of a business following an insured loss prompted him to complete a Doctoral thesis, involving 6 years of extensive research.

Over the past 6 years, Allan has been engaged to review the insurance programs and the level of sum insureds for businesses, including multi-nationals, to ensure adequate declared values, indemnity periods and cover.

Allan has lectured at RMIT on Claims Management, and has delivered over 200 papers at seminars on Business Interruption, Property Insurance and other insurance-related topics. Dr Manning is the author of five books on insurance subjects.