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Light My Fire: Perils Exclusions and Spontaneous Combustion

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Introduction

In the recently decided matter of *Dalby Bio-Refinery Ltd v Allianz Insurance Limited*,[1] the Federal Court of Australia has provided a helpful reminder of how courts will approach the construction of exclusion clauses in insurance policies when the insured and insurers are asserting that contrary meanings apply.

Background

From July 2015, the respondents (**insurers**) insured the applicant (**Dalby**) pursuant to an industrial special risks policy (**Policy**). The Policy provided indemnity to Dalby in respect of any loss or damage at Dalby's bio-refinery premises, subject to various exclusions.

During the Policy period, Dalby's stockpile of dry distillers' grain and solubles stored at Dalby's premises (**Product**) was damaged. The Product was stored in four bays: known as Bay 1, Bay 2, Bay 3 and Bay 4.

Damage to the Product was first detected when smoke appeared in Bay 2. Although tests indicated the Product was unlikely to develop into large scale combustion, there was significant discolouration to the Product in Bay 2 and a burnt smell was detected. Consequently, the entire stockpile of the Product in Bay 2 was discarded.

Subsequent inspections of the Product in Bays 1 and 3 also uncovered significant damage and those stockpiles were also discarded. The Product in Bay 4 showed no sign of damage.

The Policy

It was common ground between the parties that the Policy responded to damage occasioned by the disposal of the Product. However, the insurers sought to decline coverage for the claim under a perils exclusion, which was in the following terms:

> '***Perils Exclusions:***
>
> *The Insurer(s) shall not be liable ... in respect of:-*
>
> *6. physical loss, destruction or damage occasioned by or happening through:-*
>
> *...*
>
> *(c) (i) spontaneous combustion*
>
> *(ii) spontaneous fermentation or heating or any process involving the direct application of heat.*

Provided that Perils Exclusions 6(c)(i) and 6(c)(ii) shall be limited to the item or items immediately affected and shall not extend to other property damaged as a result of such spontaneous combustion, fermentation or heating or process involving the direct application of heat.'

The Referee Report

The parties appointed a referee to consider the following questions:

a) Whether it was more likely than not, that the damage was caused by or happened through: (i) spontaneous combustion of the Product; (ii) or spontaneous fermentation; (iii) or heating; (iv) or any process involving the direct application of heat.

b) Whether it was more likely than not, that the damage to the Product was caused by or happened through some other process and, if so, what caused the damage.

The referee provided two reports which were adopted by the parties. The two referee reports and the Policy constituted the entirety of the evidence in the hearing.

The referee's opinion was that it was more likely than not that the damage to the Product was occasioned by or happened through the process of the Product self-heating. However, the referee was not able to identify a single cause for the self-heating. He did however identify a number of factors that by themselves or in conjunction with other factors may have caused the self-heating.

The issue

The question for the court was whether the insurers were entitled to rely on the perils exclusion to decline coverage for Dalby's claim. Dalby's position was the insurers had failed to discharge their burden of proving that the perils exclusion applied. Dalby's principal arguments were:

a) The referee was unable to determine the proximate cause of the damage;

b) '*Self-heating*' does not fall within the relevant perils exclusion since the exclusion clause should be interpreted to exclude cover for '*spontaneous heating*' only; and

c) The conclusion that '*self-heating*' had occurred was not to identify a cause. Rather, the referee was unable to determine the proximate cause of the damage to the Product.

The insurers' case was that

a) The terms of the exclusion were clear and that the damage claimed fell within clause 6(c)(ii) of the perils exclusion for damage occasioned by or happening through '*heating*'.

b) The terms of the clause make it clear that it is not limited to '*spontaneous heating*'; and

c) Even if this is not the case, '*self-heating*', which was identified as a proximate cause by the referee, falls within the definition of '*spontaneous heating*'.

Decision

Given the interconnected nature of the parties' contentions, the court dealt with them in three categories: the construction of the exclusion clause; the meaning of '*spontaneous*' heating; and the proximate cause of the damage.

Construction of the Exclusion Clause

The court confirmed that the meaning of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, in light of the contract of insurance as a whole.[2] Further, if an exclusion clause is open to two interpretations, one of which would inappropriately circumscribe the cover provided by the insuring clause and one which would not, the latter is to be preferred (the '*contra-proferentem'* rule).

In considering the terms of the exclusion clause, the court disagreed with Dalby's contention that the term '*heating*' in clause 6(c)(ii) should be properly construed to mean '*spontaneous heating*'. The court found that it was '*tolerably plain*', from both the exclusion's wording and having regard to the relevant context, that the insurers were not prepared to accept a risk of damage to the Product occasioned by or happening through heating of any type (i.e. whether it was spontaneous or otherwise).

The court considered the wording of the exclusion as a whole and found against Dalby's position that the entirety of clause 6(c)(ii) should be qualified by the word '*spontaneous*'. This was particularly in circumstances where the third factor excluded in clause 6(c)(ii) ('*any process involving the direct application of heat'*) involves an external process that could not occur spontaneously. It was therefore incorrect to maintain that '*spontaneous*' was intended to apply to clause 6(c)(ii) generally and not simply to apply to the word it appeared directly before in the clause (i.e. fermentation).

In addition to the above, the court disagreed with Dalby's position that there was enough ambiguity in the wording of the clause such that the '*contra proferentem'* rule ought to apply in Dalby's favour.

Meaning of *'spontaneous'* heating

Despite finding against Dalby's arguments regarding the construction of the exclusion, the court went on to find that the self-heating referred to by the referee would, in any event, be a form of '*spontaneous*

heating' and therefore fall within the exclusion proffered by Dalby.

In circumstances where '*spontaneous*' was not defined in the Policy, the court considered the word's ordinary, usual and relevant meaning by reference to various dictionary definitions. The court found that the ordinary meaning of the word '*spontaneous*', is that it describes the occurrence of something without external cause. Although the term often relates to something that occurs with some rapidity, when the term is used in the context of describing a form of heating, the court found it means simply that it occurs without external factors.

Given it was the referee's opinion that the damage to the Product was caused by the process of self-heating (and not by any external cause), the heating described by the referee was in any event '*spontaneous heating*'. Therefore, if self-heating was a proximate cause of the damage, the exclusion would apply even if Dalby's construction of the exclusion was preferred.

Proximate cause

The above findings were however insufficient by themselves to determine the case in the insurers' favour because Dalby also submitted the insurers had failed to establish that self-heating was the proximate cause of the damage. Dalby highlighted the referee's inability to identify a single cause as the basis for the self-heating and the fact he noted that various factors either together or in isolation may have caused the self-heating.

Dalby submitted that it could therefore not be said that self-heating was the real and proximate cause of the damage, but rather the referee could not identify what, in fact, caused the loss and damage to the Product.

The court however found that the referee had clearly determined that self-heating was a proximate cause of the damage. It was therefore unnecessary for the insurers to establish the cause of the self-heating in order to rely on the exclusion. The question of what caused the self-heating was a separate issue and the factors that may have caused the self-heating could not be correctly described as the proximate cause of the damage.

Conclusion

For the reasons outlined above, the court found in favour of the insurers and held that the exclusion operated such that the insurers were entitled to decline indemnity for the claim.

While the case ultimately turned on its own facts, it provides a useful reminder to insurers of the principles the courts will apply when construing exclusion clauses and policies generally. In particular:

a) The meaning of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, in the light of the contract of insurance as a whole;

b) If an exclusion clause is open to two interpretations, one of which would inappropriately circumscribe the cover provided by the insuring clause and one which would not, the latter is to be preferred; and

c) Where a term is undefined, the court will give the term its ordinary, usual and relevant meaning.

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[1] [2018] FCA 1806.

[2] *Selected Seeds Pty Ltd v QBEMM Pty Ltd* [2010] HCA 37.

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