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Insurance Policy exclusions for *'flood'* and the importance of the language deployed - Part II

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In the January 2018 edition of Constructive Notes®, consideration was given to a number of case authorities in relation to the operation of commonly encountered insurance policy exclusions for *'flood'*.

On 1 June 2018, Davis J delivered judgment in *Wiesac & Anor v Insurance Australia Group Limited* [2018] QSC 123.

In this case the Plaintiffs held a policy of insurance with the defendant styled *'Industrial Special Risks Insurance Policy (Steadfast Mark V)'* (**the policy**). The proper construction of the policy was in dispute, however as noted [at 12] it was not contentious for the most part that the loss suffered was of the type to which the policy would respond subject to the operation of an exclusion clause upon which the defendant relied in rejecting the plaintiffs' claims and it was common ground that the burden of proving the application of the exclusion clause fell on the defendant.

The background facts giving rise to the claims were set out at paragraphs 9 and 10 of the judgment:

> [9] In early January 2011, Brisbane and other parts of Queensland experienced significant flooding. At some time in either the late evening of 11 January 2011 or the early hours of 12 January 2011, water entered through the wall of the basement of the premises damaging the second plaintiff's fit out and causing disruption to the second plaintiff's legal practice. As a result of the damage, rental payable to the first plaintiff by the second plaintiff was abated and the lost rental forms the basis of the first plaintiff's claim.
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> [10] Initially, the premises could not be accessed at all and the entire rent was abated. Later, parts of the premises were fit for occupation and use but the basement area was so badly damaged by water that the fit out was replaced.

Rental calculated to relate to the basement was abated until repairs were completed. The first plaintiff claims against the policy for the lost rental. The second plaintiff claims against the policy for the cost of clean-up of the basement, replacement of the fit out, loss attributable to business interruption and some associated financial expenses.

Paragraphs 21 and 22 set out how the basement flooded:

[21]... The premises is situated in Mary Street between Edward Street and Albert Street. Mary Street runs parallel to Margaret Street. The premises fronts onto Mary Street. There is a storm water drain which runs along the back of the premises and there is another drain running in Mary Street in front of the premises. Water from the land (local run off) which enters the drainage system through the drain in Mary Street in front of the premises travels into Albert Street, then into Margaret Street, and then on to a point of discharge into the Brisbane River just beyond Felix Street. However, if the water levels in the Brisbane River are high enough, water in the river (**river water**) can impact the volume in the drains in different ways. Firstly, the river water can prevent the local run off from entering the river at the discharge point. The local run off will remain in the drains. Further, depending upon the river level, river water might leave the river and enter the drainage pipes. In that case, there will no doubt be some mixing of local run off and river water. Naturally, in these conditions, the level of the river will determine the extent to which the river water travels up the drainage pipes.

[22] The drains are old and consist of vitrified clay pipes. Inspection of the pipes utilising a device fitted with a camera showed the drains to be in fairly poor condition. Many are cracked or breaking. Pieces of the pipes are displaced from position and some joints are also displaced. Tree roots have entered the drains at some points, and at some points there is sediment present. It is common ground between the hydrologists who gave expert evidence in the case that water which was in the pipes has been forced under pressure through cracks in the pipes and into the subterranean soils between the pipes and the basement. That water, together with water already in the subterranean soils (**groundwater**), has been pushed into the basement.

After considering the evidence of the hydrologists, Davis J found [at 49]:

1. The river levels began to steadily rise from just before midday on 11 January 2011, although there was a slight drop at about 8pm.
2. Over the period 11 January 2011 to 15 January 2011, the groundwater table remained lower than the level of the basement of the premises.
3. Some water was present in the subterranean soils between the pipes and the basement wall in the period prior to 6am on 12 January 2011 but that water was from precipitation leaching down through the soils.
4. The local runoff did not fill the drainage pipes.
5. There was no overflow from the river to the premises; the river level remained at all times below the level of its banks.

The Terms of the flood exclusion were set out at paragraph 62:

'The Insurer(s) shall not be liable under Sections 1 and/or 2 in respect of:

…

3. Physical loss, destruction or damage occasioned by or happening through

(a) flood, which shall mean the inundation of normally dry land by water escaping or released from the normal confines of any natural water course or lake whether or not altered or modified or of any reservoir, canal or dam;

(b) water from or action by the sea, tidal wave or high water:

Provided that Perils Exclusions 3(a) and 3(b) shall not apply if loss, destruction or damage is caused by or arises out of an earthquake or seismological disturbance.'

Having observed [at 63] that there was no evidence of *'earthquake or seismological disturbance'* Davis J noted [at 64]:

'In construing the exclusion clause, the aim is to objectively discern the parties' intentions by reference to the words of the clause in the context of the whole document. As the policy is a commercial contract, regard should be had to "the commercial circumstances which [it] addresses and the objects which it is intended to secure' [citing *McCann Switzerland Insurance Australia Ltd* (2000) 203 CLR 579 at [22]]

Davis J noted [at 65] that while the clause must be construed as a whole, it was useful to consider the constituent parts of the flood exclusion, which His Honour proceeded to do, under the following headings:

Physical Loss, destruction or damage occasioned by or happening through

Davis J stated [at 66]:

'The flood exclusion identifies an event (here, relevantly, flooding) and then excludes liability for "physical loss, destruction or damage" which is "occasioned by or happening through" the "flood" as defined. The "flood" here is the "inundation" of "normally dry land", being the subterranean soils or the basement, by water which is "escaping" from the "natural confines of [the Brisbane River]".'

In noting that *Mercantile Mutual Insurance (Aust) Ltd v Rowprint Services (Victoria) Pty Ltd* [1998] VSCA 147 (which said the words *'occasioned by or happening through'* have a wide meaning) has been followed consistently in Queensland, Davis J said [at 69] that therefore much of the difference of opinion between the competing experts in the case ceases to be relevant. His Honour went on to say [at 69]:

'The defendant's case is that the subterranean soils between the pipes and the wall of the basement of the premises is "normally dry land" and that at least some of the water which leaked from the pipes was river water "escaping from the normal confines of [the river]". If that is established, then the damage is damage "occasioned by or happening through" the "food", because the river water leaking from the drainage pipes has made its way to the basement and/or has pushed groundwater into the basement. The entry of groundwater into the basement has been "occasioned by" or has "happened through" the river water being forced under pressure into the subterranean soils (the "normally dry land"). The local runoff is not water "escaping the normal confines of [the river]." Damage has no doubt been occasioned by local runoff. The legal effect of that is explained later. However, as the river levels rose and the proportion of river water escaping the pipes rose, no doubt river water pushed local runoff (already expelled into the subterranean soils) into the basement.'

Davis J then stated :

'[71] *River water has entered the subterranean soils. River water also entered the basement. As explained, the entry of river water into the subterranean soils has caused river water, local runoff and groundwater to enter the basement and cause damage. Therefore, if the "normally dry land" is (or includes) the subterranean soils, then the damage to the basement is loss "occasioned by or happening through" the escape of river water into the subterranean soils.*

[72] *However, local runoff has also entered the subterranean soils and contributed to the damage in the basement. Similarly, if the "normally dry land" is the basement, the damage is "occasioned by or happening through" the escape of river water, and also local runoff.'*

[73] *Consequently, this is a case where there are multiple causes of the damage and only one of those causes is caught by the flood exclusion. That raises consideration of Wayne Tank and Pump Co Ltd v Employers Liability Insurance Corporation Limited.*

[74] *There is, in the authorities, fairly regular reference to what is called the "Wayne Tank principle". That principle is said to be that where there are two proximate or substantial causes of the one loss and only one falls within an exclusion clause, the insurer may rely upon the exclusion and avoid liability. However, there must be some doubt that Wayne Tank establishes any general principle; rather, it establishes that the proper construction of most exclusion clauses will in fact lead to a result that an insurer will avoid liability under an exclusion clause where one or more proximate causes of the loss falls within the clause.'*

And then:

> [78] *Here, all the damage to the basement is loss "occasioned by or happening through" the escape of water from the river. This is because it was the back up of water from the river which caused the pressure in the pipes to rise to a point where water was forced into the subterranean soils. However, it is not the escape of river water into the pipes which activates the exclusion. It is the escape of water into "normally dry land", here the subterranean soils or the basement.*
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> [79] *The majority of the water that entered the basement was river water. It follows then that the majority of the water which entered the subterranean soils was river water. Certainly then, the dominant cause of the loss is the "inundation of normally dry land by water escaping from the normal confines of [the river]". There is only one loss, being the damage caused by the body of water which entered the basement.*
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> [80] *The loss, then, has concurrent causes, namely the damage by the river water, and that by other water. Policies containing such flood exclusion clauses have been construed to exclude liability of the insurer in those circumstances. Here, on a proper construction of the exclusion clause, as the river water was a cause, and indeed the dominant cause of the loss occasioned by the damage to the basement, then assuming that the clause otherwise applies, the exclusion clause is engaged and will defeat the plaintiffs' claim.*

Inundation of normally dry land

Davis J had noted [at 70] that there was a dispute as to what is potentially the *'normally dry land'* for the purpose of the flood exclusion; the basement itself, and/or the subterranean soils between the pipes and the basement, with the plaintiff submitting that neither the subterranean soils nor the basement were, relevantly to the policy, *'normally dry land'*.

Davis J, stated [at 84]:

> *'It is necessary to consider the purpose of the clause viewed against its presence in a commercial contract. It would be a very curious result if the relevant loss is damage caused to the "Property Insured", but the "Property Insured" is not "normally dry land" for the purposes of the flood exclusion. What is intended is to exclude liability in circumstances of "flood". The flood exclusion does this by excluding liability where the loss is occasioned by or happens through the inundation of normally dry land which may include the premises insured. This conclusion is consistent with Eliade Pty Ltd v Nonpariel Pty Ltd and LMT Surgical Pty Ltd v Allianz Australia Insurance Ltd. Therefore, the entry of river water into the basement was entry of water into "normally dry land".'*

His Honour then went on to consider whether the leakage into the subterranean soils was not relevantly *'inundation'* and secondly whether the subterranean soils were not in any event *'normally dry'*.

As to the first issue, Davis J concluded [at 92]:

> *'The purpose of the exclusion is to exclude liability for damage caused by flooding, namely the damage caused by water escaping from, relevantly here, the river. There is no room to limit the meaning of the term the "inundation" of "normally dry land" to mean "the inundation of the surface or normally dry land".'*

As to the second issue, Davis J said [at 86]:

> *'I reject the submission that the subterranean soils were not "normally dry". There was certainly groundwater at some level in the subterranean soils. The groundwater level in the vicinity of the basement was usually between 1.5 and 2.7 AHD. While the experts agreed that the heavy rainfall may have raised the level, that level was impossible to ascertain. Any significant leakage of water from the pipes would only occur when the pipes were under pressure; that is when there was significant rainfall or other events to fill them. There was therefore generally not water present in the soils at the level of the pipe of the basement'.*

After considering what had been said by *Mansfield J in Eliade Pty Ltd v Nonpariel Pty Ltd* (2002) 124 FCR 1 [at 50], Davis J went on to state [at 88]:

'In one sense, once it is accepted that rainfall is "normal", no land other than that in completely arid areas would be "normally dry land" as the land would not be dry during periods of rainfall. His Honour's approach to the construction of the term "normally dry land" must, with respect, be correct. The usual character of the subterranean soils between the pipes and the basement wall, at least at the relevant time level is usually dry. It is "normally dry land".'

His Honour concluded [at 93]:

'In any event, for the reasons already explained ... [at 83 where His Honour found that the term *'normally dry land'* included in this case the land occupied by the buildings and also includes other land which is *'normally dry'*] *... the insured premises may be the "normally dry land" for the purpose of the exclusion. The basement of the premises is "land", it being a fixture on land, and clearly, the basement is "normally dry".'*

Escaping or released from the normal confines of any natural water course whether or not altered by any reservoir, canal or dam

In noting [at 94] that the Brisbane River was obviously a natural water course and that there was no submission that the pipes themselves were part of the natural water course or were a canal, Davis J firstly considered whether run off which was unable to drain into the river because of back up of river water in the pipes is water *'escaping [the river]'*.

After considering *Hams & Anor v CGU Insurance Limited* (2002) 12 ANZ Insurance Cases 61-525 Davis J noted [at 100] that the passage quoted in that case by Einstein J from *Provincial Insurance Australia Pty Limited v Consolidated Wood Products Pty Limited* was on a different point, and further that both *K Sika Plastics Limited v Cornhill Insurance Co Limited* and *Oakleaf v Home Insurance Ltd* concerned flood exclusions which focused on *'overflow'*. His Honour went on to say [at 101]:

'Here the flood exclusion applies to water "escaping from or released from [the river]". In context, both "escaping" and "released" "from" the river assumes that the water has at one time been in the river. Therefore it is the river water, and not the local runoff, which is caught by the flood exclusion. The exclusion does not apply to damage done by water that could not reach the river unless the damage caused by that water was damage "occasioned by or happening through" the "inundation of normally dry land by [the river water]". I reject... [the submission]... that water that could not reach the river was water escaping the river.'

In then noting [at 102] that the submission that water escaping from the pipes was not water escaping from the river relied heavily on the decision of Jackson J in *LMT Surgical Pty Ltd v Allianz Australia Insurance Ltd* [2014] 2 Qd R 118, Davis J stated [at 105]:

'There is only one word which is different in the present flood exclusion to that considered in LMT. In LMT, the flood exclusion applied to water that is "overflowing from the normal confines of [the river]". The flood exclusion here applies to "water escaping from the normal confines of [the river]". Water may escape "the normal confines of [the river" through drainage pipes. The flood exclusion in LMT only applied to water escaping the normal confines of the river in a particular way, i.e. by overflowing the banks'.

Finally, in rejecting [at 106] the submission that water is not *'escaping'* but has *'escaped'* once it leaves the confines of the river, His Honour went on to state:

'...Only water which has actually left the confines of the river can do damage and cause loss, relevantly by "inundating normally dry land". Therefore, for the exclusion clause to have any operation to exclude loss caused by escaping water, the water must be, for the purpose of the clause, still in the act of escaping after leaving the confines of the river. The point at which water ceases to be "escaping" and has "escaped" obviously is a matter of fact. However, here all the experts say that river water entered the subterranean soils between the pipes and the basement wall and entered the basement. That water was therefore "escaping from the confines of [the river]" and inundated "normally dry land", namely the subterranean soils and the basement of the premises'.

Findings on the exclusion clause

In the context of the present case His Honour found that the exclusion clause operated as follows:

> [108] '*The damage to the basement was caused by water from various sources:*
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> 1. *River water in the pipes;*
> 2. *Local runoff in the pipes; and*
> 3. *Groundwater in the subterranean soils between the pipes and the basement.'*
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> [109] '*The river water entered the subterranean soils ('normally dry land'), and the basement ('normally dry land'), and in the process pushed groundwater into the basement. The river water was water 'escaping the confines of [the river]'. The entry of the river water into subterranean soils and the basement was an inundation of the two places.'*
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> [110] '*Damage done by the river water and the groundwater pushed into the basement by the river water was damage 'occasioned by or happening through: the escaping river water.'*
>
> [111] *'Damage done by local runoff entering the basement is not damage caused by 'flood', but on a proper construction of the flood exclusion, the exclusion is available to the defendant.'*
>
> [112] *'The plaintiffs' claims are excluded by the flood exclusion.'*

Conclusion

An insurer bears the onus in establishing that a particular claim falls within an exclusion clause [*Pye v Metropolitan Coal Co Ltd* (1934) 50 CLR 614, 625].

In relation to exclusions of damage by flood, as was observed by His Honour Jackson J in the prior Queensland case of *LMT Surgical v Allianz Australia Insurance Ltd* [2014] 2 Qd R 118 [at 21] the scope of the cover or exclusion of damage caused by flood, depends on the specific language deployed in the particular policy on the subject matter and is not determined by the meaning of other policies which deploy other language or by broad statements as to purpose or object.

The decision of Davis J noted above might be thought to provide an illustration of this, for as His Honour observed [at 105] there was only one word which was different in the flood exclusion under consideration in the case before His Honour to that considered by Jackson J in *LMT*, which led to that case being distinguished on the facts.

Disclosure - Carter Newell and the author acted for the defendant insurer in *Wiesac Pty Ltd v Insurance Australia Limited* [2018] QSC 123

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