COVID-19: INSURANCE - UK SUPREME COURT JUDGMENT BRINGS POSITIVE NEWS FOR POLICYHOLDERS IN THE FCA'S BUSINESS INTERRUPTION TEST CASE

Date: 19 January 2021

UK Insurance Alert

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BACKGROUND TO THE TEST CASE

Following a four day hearing in November 2020, the UK Supreme Court has handed down the appeal judgment in the test case brought by the Financial Conduct Authority (FCA) on behalf of UK based small and medium enterprises (SMEs) seeking clarity on the coverage provided by certain extensions of cover for COVID-19 related business interruption losses (The Financial Conduct Authority v Arch and Others). The test case related to the interpretation of certain Disease Clauses, Prevention of Access and so-called Hybrid Clauses, and whether or not they provide insurance cover under English law for business interruption losses resulting from the COVID-19 pandemic and related measures taken by UK authorities. Further information on the High Court judgment can be found in our alert 'COVID-19: Considering the Wider Implications of the FCA's Test Case' from 22 September 2020.

At first instance, the High Court considered the application and interpretation of 21 sample policy wordings, and the Court accepted many of the FCA's arguments relating to the coverage provided, particularly in relation to Disease Clauses. The FCA chose to appeal certain issues which had not been decided in its favour, as did the Hiscox Action Group which participated in the proceedings. Six of the eight insurer defendants chose to appeal specific points of construction as well as other issues, particularly causation, trends clauses and the approach to the Commercial Court decision in the Orient Express case.

The Supreme Court unanimously dismissed the insurers' appeals and allowed all four of the FCA's appeals, which serves as positive news for many policyholders looking to advance claims for business interruption losses suffered as a result of the COVID-19 pandemic.

The following is a brief summary of the issues determined by the Supreme Court, which are set out in the 112 page judgment.

DISEASE CLAUSES

The Supreme Court focused on the wording of the Disease Clause in a Royal & Sun Alliance policy, which they regarded as an exemplar. This clause (like many other Disease Clause wordings) covers business interruption

losses resulting from any occurrence of a notifiable disease within a specified geographic radius of the insured premises.

The High Court interpreted this type of wording as covering business interruption losses stemming from the COVID-19 pandemic provided there had been an occurrence (meaning at least one case) of the disease within the specified geographical radius. The Supreme Court took a narrower approach to identifying the insured peril or trigger, concluding that such clauses are properly interpreted as providing cover for business interruption caused by any cases of illness resulting from COVID-19 that occur within the relevant radius. They accepted the Insurers' arguments that each case of the disease was a separate “occurrence” and such clauses only apply to cases within the radius (as opposed to cases elsewhere). However, because of their findings on causation, they arrived at a similar outcome i.e. that the cover applied.

PREVENTION OF ACCESS AND HYBRID CLAUSES

Prevention of Access Clauses typically provide cover for business interruption losses resulting from public authority intervention preventing access to, or use of, the insured premises. Hybrid Clauses combine certain elements of Disease Clauses and Prevention of Access clauses.

The Supreme Court considered the nature of the public authority intervention required to trigger Prevention of Access/Hybrid Clauses, specifically whether the intervention had to have the force of law. The Supreme Court rejected the interpretation that “restrictions imposed” by a public authority applied only to restrictions which are expressed in mandatory terms and have the force of law. The Court deemed this interpretation too narrow and stated that an instruction given by a public authority may amount to a “restriction imposed” if it carries the imminent threat of legal compulsion or is in mandatory and clear terms and indicates that compliance is required without the use of legal powers. The Court refused to rule on whether general or specific measures put in place by UK authorities satisfied this test but suggested that the argument is stronger in relation to the latter, such as certain instructions in mandatory terms from the Prime Minister to close business premises.

The Supreme Court considered the nature of the prevention or hindrance of access required to trigger the clause, specifically the effect of clauses which cover business interruption losses caused by the “inability to use” the insured premises. The Court agreed that inability rather than hindrance of use of the premises must be established, but found that this requirement may be satisfied where a policyholder is unable to use the premises for a particular activity or is unable to use a part of the business premises. While the Court acknowledged that all cases would be fact specific, they gave the example of a department store which had to close all parts of the store except its pharmacy as one involving the inability to use a discrete part of the premises. The Court interpreted clauses requiring “prevention of access” in a similar manner i.e. it could cover prevention of access to a discrete part of the premises or for the purpose of carrying out a discrete part of the business activities.

It follows that Prevention of Access/Hybrid clauses may be triggered more readily than previously suggested and policyholders should consider revisiting the language of such clauses in light of the Supreme Court judgment.

CAUSATION

With respect to Disease Clauses, the key issue was whether business interruption losses resulting from health measures taken in response to COVID-19 were, as a matter of law, caused by cases of the disease that occurred with the specified radius of the insured premises. The Supreme Court concluded that the relevant measures were

taken in response to information about all cases within the UK as a whole, such that all individual cases of COVID-19 which had occurred at the date of any measure by the UK Government were equally effective "proximate" causes of those measures. It is therefore sufficient for policyholders to show that, at the time of any Government measure, there was at least one case of COVID-19 within the relevant policy area.

In reaching this conclusion, the Supreme Court rejected the insurers' arguments that one event cannot, in law, be a cause of another unless it can be said that the second event would not have occurred in the absence of ("but for") the first. The Court also rejected the insurers' argument that cases of disease occurring inside and outside the specified radius should be viewed in aggregate, and therefore the overwhelmingly dominant cause of any UK Government measure will inevitably have been cases of COVID-19 occurring outside the specified geographical area. The Court explained that the "but for" test of causation is sometimes inadequate, and that there can be situations, of which the present case is one, where a series of events all cause a result although no single event was individually necessary or sufficient to cause the result by itself. In the present case, the Court accepted the FCA's argument that the parties could not reasonably have intended that cases of disease outside of the insured radius could be set up as a countervailing cause which displaces the impact of the disease within the radius. The proper interpretation of such clauses was that, in order to show that loss from interruption of the business was proximately caused by one or more occurrences resulting from COVID-19, it was sufficient to show that the interruption was the result of Government action taken in response to the disease which included at least one case within the relevant policy area.

With regard to Prevention of Access/Hybrid clauses, the Supreme Court concluded that business interruption losses are covered only if they result from all elements of the risk covered by the clauses operating in the sequence required by the particular wording. However, the fact that such losses were also caused by other (uninsured) effects of the COVID-19 pandemic does not exclude them from cover under such clauses.

TRENDS CLAUSES

Most of the policies considered in the test case included "trends clauses" which provide for business interruption losses to be calculated by adjusting the results of the business in the previous year to take account of trends or other circumstances affecting the business, in order to estimate the results that would have been achieved if the insured peril had not occurred.

The Supreme Court determined that these clauses are part of the machinery included in the policy for the purpose of quantifying loss and should not be interpreted so as to reduce the cover provided by the relevant insuring clause. It follows that the trends and circumstances upon which the adjustments are based must not include circumstances arising out of the same underlying cause as the insured peril.

This means that any factors or effects relating to or stemming from the COVID-19 pandemic should be disregarded when assessing trends or circumstances impacting the business for the purpose of calculating business losses to be indemnified by insurers.

PRE-TRIGGER LOSSES

At first instance, the High Court held that, if there was a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered, then in principle the continuation of that measurable downturn

and/or increase in expenses could be taken into account as a trend or circumstance affecting the business in calculating the loss to be indemnified.

The Supreme Court disagreed with this conclusion and asserted that the above principles in relation to trends clauses apply to pre-trigger downturns in revenue. This means that only circumstances affecting the business which are unrelated to the insured peril and its underlying cause (in this case COVID-19) are permitted to be used when reducing the amount of loss. The Court gave the example of a public house suffering a downturn just prior to the UK Government's instructions in relation to COVID-19 due to public concern about the disease. The Court stated that the insurer's indemnity should be calculated by reference to what would have been earned by the business had COVID-19 not occurred, disregarding any revenue drop prior to the UK Government's instructions that resulted from COVID-19.

THE ORIENT EXPRESS

The Orient Express case (*Orient Express Hotels v Assicurazioni General* [2012] Lloyds Rep IR 531) was relied on heavily by the insurers in the test case in support of its arguments on causation of loss and the effects of trends clauses.

Orient Express concerned a claim for business interruption losses arising from hurricane damage to a hotel in New Orleans. The claim was made under an all risks property damage policy which contained a trends clause which had similar wording to those considered in the test case. The case was considered by the High Court on appeal from an arbitration tribunal, the appeal being limited to questions of law arising out of the arbitral award. The case was decided by a member of the Supreme Court panel and another member of the panel served as one of the three arbitrators. Cover was confirmed for the physical damage to the hotel but, when it came to business interruption losses, the arbitration panel (and the High Court) accepted the insurers' argument that the cover did not extend to business interruption losses which would have been sustained in any event, as a result of hurricane damage to the city of New Orleans, even if the hotel itself had not been damaged.

In light of its conclusions on causation, the Supreme Court concluded that the High Court had been wrong to hold that business interruption loss was not covered by the insuring clause to the extent it did not satisfy the “but for” test. This is on the basis that the insured peril (damage to the hotel) and uninsured peril (damage to the rest of the city) operated concurrently and arose from the same underlying fortuity (the hurricane) such that loss arising from both causes operating concurrently should have been covered.

Applying their earlier conclusions regarding the effect of trends clauses, the Supreme Court concluded that the correct approach in that case would have been to interpret the trends clause so as to exclude from the assessment of what would have happened if the damage had not occurred in those circumstances which had the same underlying cause as the damage, namely the hurricanes.

The Supreme Court therefore determined that the Orient Express case had been wrongly decided and should be overruled. The Court conceded that this was one of those rare instances where they had to “surrender former views to a better considered opinion.”

CONCLUSION

The Supreme Court judgment extends the proper application of concurrent causation, and makes clear that the "but for" test is not determinative in deciding questions of proximate causation in all cases. It remains a relevant test, and the Court acknowledged that in most cases it would be the appropriate test to be applied. However, the Court stated that the test will not be appropriate where its application results in a narrowing, or removal, of cover in circumstances where, based on the interpretation of the policy as a whole, that cannot have been the original intention of the parties.

To conclude, the Supreme Court judgment, which followed a "leapfrog" appeal from the High Court and an expedited hearing, brings long-awaited guidance for SMEs on the scope of cover for COVID-19 related business interruption losses. The judgment will be binding on those insurers who were party to the proceedings and provides guidance to insurers and policyholders with similar policy wordings. In addition to favourable findings for policyholders on issues relating to causation and the proper application of trends clauses, the Supreme Court took a more flexible approach to Denial of Access/Hybrid Clauses, concluding that cover may be available for partial (as well as full) closure of premises and as a consequence of mandatory orders which are not legally binding. Policyholders should consider revisiting such clauses to assess whether their coverage position is more favourable as a consequence of the Supreme Court judgment.

If you would like to discuss any of the issues addressed in this alert, or business interruption insurance generally, please contact Sarah Turpin.

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