COVID-19: FCA BUSINESS INTERRUPTION TEST CASE - UNRESOLVED ISSUE AND WIDER IMPLICATIONS OF SUPREME COURT JUDGEMENT

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By: Sarah Turpin, Oliver Richardson, Edward A. Brown-Humes

On 15 January 2021, the Supreme Court handed down its judgment in *The Financial Conduct Authority v Arch and Others*. Our alert of 19 January 2021 considered the implications of the judgment for policyholders seeking to claim for business interruption losses inflicted by the COVID-19 pandemic. The judgment represents the final word on the issues considered in the test case and is generally helpful to policyholders with non-damage business interruption coverage extensions. However, as noted in this alert, the judgment left some issues unresolved, particularly in relation to certain coverage clauses and how claims should be quantified. In relation to those issues that were decided, the judgment is likely to have wider implications for English insurance law generally. In particular, the Supreme Court considered issues of causation and trends clauses in far greater detail than the High Court judgment (for which see our alert of 22 September 2020). This alert briefly considers how the law has changed in light of the judgment and looks at certain practical issues that policyholders may need to consider going forward.

PROPERTY DAMAGE

The main insuring clauses for business interruption cover typically require some form of, or connection to, physical loss, damage, or destruction in order for cover to be triggered. When the Financial Conduct Authority (FCA) commenced test case proceedings, it recognised that there may be questions in relation to whether policyholders may prove physical loss or damage through the presence of COVID-19, absent specific allegations that property had been altered by the virus or its consequences. The focus of the test case was therefore on a sample of 'non-damage' coverage extensions (i.e., policy extensions that do not require physical loss or damage in order to be triggered).

The Courts have considered one case in which the claimant (a café in London) attempted to argue that the temporary loss of use of its premises as a result of COVID-19 amounted to physical loss sufficient to trigger insurance cover (*TKC London Limited v Allianz Insurance Plc* ([2020] EWHC 2710 (Comm)). The Court rejected all of the claimant's arguments on this point, and held that the claimant's temporary loss of use of its premises was not sufficient to amount to physical loss for the purpose of the insurance cover. Each case is, however, likely to turn on its own facts, and the specifics of the policy wording, and the claimant ran several arguments peculiar to its own type of business.

AT THE PREMISES

In the context of the FCA test case, whilst the Court's interpretation of Notifiable Disease extensions was generally very favourable to policyholders, there are certain types of clauses that were not considered. In particular, some Notifiable Disease extensions require the “occurrence” of the disease at the insured premises, as opposed to within the vicinity or within a certain radius. It is not clear why these clauses were not considered and clearly certain aspects of the Supreme Court's decision will apply to these clauses.

NAMED DISEASES

The test case failed to address Notifiable Disease extensions which specify a list of named diseases for which cover may respond. In the recent case of *Rockliffe Hall Ltd v. Travelers Insurance Co. Ltd.* ([2021] EWHC 412 (Comm), the insured's extension specified 34 such diseases, and COVID-19 was not included on that list. The claimant argued that, whilst several of the listed diseases were caused by specific pathogens (such as Malaria), others were described in much more general terms (such as “Food or Drink poisoning”, or “Plague”), which could encompass, or result from COVID-19. As a result, the claimant argued the list was non-exhaustive and the “general diseases” should be given broad interpretation. In particular, it argued that “Plague” should “be read as a general term for an infectious disease with a high mortality rate, epidemic or pandemic.” Furthermore, other “general diseases” such as “Food and Drink poisoning” could be caused by, and therefore encompassed, COVID-19. In striking the claim out, the judge noted that this interpretation was one that no “remotely reasonable reader would arrive at.”

This case demonstrates the difficulties that policyholders may encounter with named disease clauses, given COVID-19 will not be specified by name in policies entered into pre-pandemic. However, some clauses may be in broader terms that could encompass COVID-19, and therefore provide cover, such as by listing a category of diseases (e.g., coronavirus disease) or referencing broad viral species names.

CAUSATION

The 'but for' test is often used in the insurance context to determine whether loss or damage was caused by an insured peril. This test considers whether 'but for' the occurrence of the insured peril, the insured would have suffered any loss. In the test case, insurers posited that the relevant test was: 'but for' the insured peril (such as occurrence of COVID-19 within the applicable radius or government action causing prevention or denial of access), would policyholders have suffered their business interruption losses? Insurers contended that, as a result of the widespread nature of the pandemic (with ramifications beyond the insured peril), the answer to that question was “yes,” such that the causation requirement was not satisfied.

The Supreme Court disagreed, and stated that the 'but for' test of causation is sometimes inadequate. It explained that there can be situations “where a series of events all cause a result although none of them was individually either necessary or sufficient to cause the result by itself”.

In such circumstances, the Supreme Court considered that the principle of proximate causation was more appropriate. In its discussion of this principle, the Court reviewed the case law on concurrent causes of loss, including *Wayne Tank & Pump Co Ltd v Employers Liability Assurance Corp Ltd* [1974] QB 57 and *JJ Lloyd Instruments v Northern Star Insurance Co* [1987] 1 Lloyd's Rep 32 (known as *The Miss Jay Jay*). In *Wayne Tank*, the Court of Appeal held that where there are two proximate causes of loss, one of which is an insured peril but

the other is expressly excluded, the exclusion will usually take precedence. In *The Miss Jay*, the Court of Appeal held that where there are two proximate causes of loss, neither of which are subject to an exclusion, but only one of which is expressly insured, insurers shall be liable for the loss.

Although the above cases only consider circumstances where two competing interdependent causes are at play, the Supreme Court stated that there was no reason why such principles cannot be applied to circumstances where multiple causes act in combination to bring about a loss. Applying this to the COVID-19 pandemic, the Supreme Court deemed that, whilst an individual case of COVID-19 could in theory have caused the UK Government to introduce restrictions, it was instead the case that such restrictions were introduced as a result of the available information regarding all cases of COVID-19 in the UK as a whole. The Supreme Court therefore considered each COVID-19 case as an individual but equal cause of the restrictions imposed, and stated that "it is realistic to analyse this situation as one in which all the cases were equal causes of the imposition of national measures."

The Supreme Court ruled that the *Orient Express* case (*Orient Express Hotels v Assicurazioni General* [2012] Lloyds Rep IR 531) was wrongly decided. That case concerned a claim for business interruption losses arising from damage to a hotel in New Orleans caused by Hurricane Katrina. The Court in that case accepted insurers' argument that the hotel's business interruption losses 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. Revisiting the case in light of its findings on proximate causation, the Supreme Court noted that the business interruption loss had two proximate causes, each of which was sufficient to cause the loss–the damage to the hotel itself, and the damage to the city of New Orleans. Applying the principles discussed above in *Miss Jay Jay* and *Wayne Tank*, the Supreme Court held that, provided losses covered by the uninsured proximate cause were not expressly excluded by the policy, losses resulting from both causes were covered because they both arose from the same proximate cause (in that case, Hurricane Katrina).

TRENDS CLAUSES

Trends clauses form part of the quantification machinery in business interruption policies, and their purpose is to ensure that the amount recovered by the insured is not affected by circumstances unrelated to the loss suffered. Having run a similar argument in relation to causation, insurers argued that trends clauses operated to reduce the amount payable to policyholders, on the basis that the wider consequences of the COVID-19 pandemic would have caused them to suffer these losses in any event.

The Supreme Court ruled that trends clauses that quantify the claim must be construed consistently with the insuring clauses that provide cover. Trends clauses may only adjust the quantum of any claim to reflect trends or circumstances that are unconnected with the insured peril. Consequently, as with causation, the result was that the wider consequences of the COVID-19 pandemic (such as the general economic downturn) could not be taken into account when adjusting business interruption claims. Only circumstances unrelated to COVID-19 could be taken into account in adjusting the loss. One hypothetical example referred to in the judgment (though not in the discussion of trends clauses) is that of a famous chef at a Michelin starred restaurant who resigned shortly before the pandemic. In those circumstances, the restaurant would likely have suffered a downturn in its business as a result of a cause wholly unrelated to the COVID-19 pandemic, and a trends clause may operate to adjust that claim as a result.

The policy in *Orient Express* contained a trends clause. In revisiting this aspect of the case, the Supreme Court held that the case had been wrongly decided and the correct approach would have been to exclude all adjustments based on the same underlying cause (Hurricane Katrina).

The Supreme Court's findings on causation and trends clauses, and its decision to overrule *Orient Express*, are likely to have wider implications beyond the COVID-19 pandemic. This is most obvious in relation to business interruption losses suffered by policyholders as a result of natural catastrophes or 'wide area damage' events such as earthquakes, storms, floods, and explosions. In such scenarios, insurers will no longer be able to factor in the wider devastation to the surrounding area when quantifying insureds' business interruption losses.

EVIDENTIAL ISSUES

Notifiable Disease clauses generally require policyholders to prove the presence of COVID-19 within a 'relevant policy area' (RPA) before the policy will respond. The FCA has recently published guidance on the types of evidence that should be acceptable to insurers. Policyholders with wider RPAs (such as 25 miles) will generally be able to rely on National Health Service (NHS) or Office for National Statistics (ONS) death data, or cases reported at the time by the UK Government. Policyholders with narrower RPAs (such as 1 mile) may have to prove a specific case of COVID-19. Whilst its list of examples is non-exhaustive, the FCA envisages that proving a specific case will generally require evidence of a positive COVID-19 test. This is despite the fact that the FCA acknowledges the lack of widespread testing at the beginning of the pandemic. Policyholders unable to prove a specific case, or unable to use the other types of data referred to above, may be able to use a statistical methodology to prove the presence of COVID-19. One such methodology is an 'under-counting analysis,' which estimates the true number of COVID-19 cases given these have generally been under-reported (particularly in the early stages of the pandemic). Some of these methods are complex, and the FCA will shortly publish a 'COVID-19 Calculator' to assist policyholders with their calculations.

QUANTIFICATION ISSUES

The Courts were not asked to consider detailed issues relating to loss quantification, with the result that there are issues that remain to be addressed, including the application of deductibles and sub-limits of liability in the context of policies covering more than one insured premises.

In recent “Dear CEO” letters to insurers, the FCA noted that insurers now have the clarity they need, following the Supreme Court judgment, to either reject or pay business interruption claims for the vast majority of their policyholders. The FCA's priority is to ensure that valid claims are now progressed as quickly as possible, and that slow payment does not continue to exacerbate financial pressures on policyholders. The expectation is that insurers should now have written to their policyholders with a decision on coverage. In practice, the approach being taken by insurers seems to vary, and policyholders in receipt of rejection letters should consider carefully whether steps should be taken to contest the insurer's position.

DAMAGES FOR LATE PAYMENT

Section 13A of the Insurance Act 2015 implied a term into every insurance contract that insurers must pay claims within a reasonable time, or they may be liable for damages arising from any delay. To date, this provision has not been tested by the Courts, but the Act states that a 'reasonable time' includes time to investigate and assess the

claim, and what is reasonable will depend on the size and complexity of the claim, as well as factors outside of the insurer's control. The FCA test case will likely be considered a factor outside the insurer's control, such that delay in paying claims while awaiting the Supreme Court judgment is unlikely to be considered unreasonable delay. However, as the judgment has now been handed down, insurers should be paying claims promptly and policyholders should be mindful of the ability to claim damages (in addition to the insured loss) if insurers continue to delay in paying valid claims.

NEXT STEPS

The FCA estimates that approximately 370,000 policyholders will be affected by the outcome of the test case. Although the test case focused on business interruption cover for small and medium businesses, there are a number of aspects of the judgment that are likely to be relevant to other insureds seeking to recover COVID-19 business interruption losses. The FCA has also suggested that the judgment will be of assistance to policyholders with different policies, such as event cancellation or landlord insurance, many of which contain similar clauses to those considered by the test case.

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Most policies require that the policyholder submit details of its claim and supporting documentation within a certain time after the loss event. The FCA has confirmed that insurers must not include the period between 17 June 2020 and final resolution of the test case (15 January 2021) when relying on these time limits. Policyholders should now collate this supporting documentation, with a view to advancing their claims as soon as possible.

Finally, given the variations between policy wordings considered in the test case, some insureds may legitimately question why they have ended up with narrower coverage. There may well be a gap between the insured's expectations and that of the insurer in terms of what should be covered. In such cases, insureds may need to consider whether they have been mis-sold their policy by their insurer or by their broker, particularly where representations were made in relation to the coverage provided for disease risks or where the policy was specifically adapted to meet the insured's risk profile.

KEY CONTACTS

SARAH TURPIN
PARTNER

LONDON
+44.20.7360.8285
SARAH.TURPIN@KLGATES.COM

