Insurance
Case Law Update
Rosling King LLP

The Dispute Resolution Case Law Update: Supreme Court decision in FCA insurance test case

Introduction

On 15 January 2021, the Supreme Court handed down judgment in relation to the question of whether or not cover was triggered under a variety of standard insurance policy wordings for business interruption losses due to the COVID-19 pandemic and the actions of the Government resulting from it, including the first national lockdown.

The test case was brought by the Financial Conduct Authority for the benefit of small and medium enterprises who hold business interruption insurance policies. It sought to clarify the interpretation and application of four commonly-used insurance coverage clauses - Diseases Clauses, Prevention of Access Clauses, Hybrid Clauses, and Trends Clauses – under business interruption insurance policies.

At first instance, the High Court found in favour of the FCA on many of the key issues. The FCA sought to appeal certain issues that had not been decided in its favour. Six of the eight insurer defendants appealed on the issue of the proper construction of wordings under their respective policies as well as on other issues, including causation.

The Supreme Court unanimously dismissed the insurers' appeals and allowed all four of the FCA's appeals. This is positive news for the many policyholders seeking to advance claims for business interruption losses suffered as a result of the COVID-19 pandemic. The key points of the decision are summarised below.

The Supreme Court's Decision

Disease Clauses

Disease clauses provide cover for business interruption losses resulting from the occurrence of a notifiable disease, such as COVID-19, at or within a specified distance of the business premises. The Supreme Court focused on the following wording of the Disease Clause in a Royal & Sun Alliance policy:

"any … occurrence of a Notifiable Disease within a radius of 25 miles of the Premises" with "Notifiable Disease" being defined as "illness sustained by any person resulting from… any human infectious or human contagious disease… an outbreak of which the competent local authority has stipulated shall be notified to them."

The High Court interpreted this type of wording as covering business interruption losses stemming from the COVID-19 pandemic provided there had been at least one case (an occurrence) of the disease within the specified geographical radius. The Supreme Court took a narrower approach to identifying the insured peril or trigger and concluded that the Disease Clause provided cover for business interruption caused by any cases of illness resulting from Covid-19 that occur within the relevant radius. The Supreme Court accepted the insurers'

arguments that each case of the disease was a separate "occurrence" and such clauses only apply to cases within the radius. However, because of their findings on causation (see below), they concluded, as the High Court did, that cover applied.

Prevention of Access and Hybrid Clauses

Prevention of Access Clauses provide cover for business interruption losses resulting from public authority intervention preventing or hindering access to, or use of, the business premises. Hybrid Clauses combine the main elements of the Disease and Prevention of Access Clauses. For the disease elements of the Hybrid Clauses, the Supreme Court reached the same conclusions as it did for the Disease Clauses.

The appeals focussed on (1) the nature of the public authority intervention required to trigger the clause, specifically whether the intervention had to have the force of law; and (2) 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 Supreme Court agreed with the High Court that "restrictions imposed" by a public authority would be understood to mean mandatory measures imposed by the authority under its statutory or legal powers. However, it did not accept that a restriction can only fall within the description if it has the force of law. Notably, the Supreme Court refused to rule on whether general or specific measures put in place by UK authorities satisfied this test.

In accepting the FCA's argument, the Supreme Court agreed that the "inability to use" requirement is 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. It was acknowledged that each case will turn on its facts. However, the Supreme Court provided an example: if a department store had to close all parts of the store except its pharmacy, this would satisfy the inability to use a discrete part of the premises.

The Supreme Court's interpretation of clauses requiring "prevention of access" was consistent with its interpretation on "inability to use". Although fact dependent, the wording of the clause may 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.

The Supreme Court's interpretation of Prevention of Access / Hybrid Clauses was broader than the High Court's interpretation, which means that such clauses may be triggered more readily.

Causation

The Supreme Court gave considerable attention to the issue of causation. Based on its interpretation of the Disease Clauses, the question of causation was of crucial importance. The Supreme Court concluded that the Disease Clauses cover only the effects of cases of COVID-19 occurring within the radius. On this basis, the question of what connection must be

shown between any such cases of disease and the business interruption loss becomes critical.

The key question identified by the Court 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 within 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.

A policyholder must therefore show that, at the time of the Government measure, there was at least one case of COVID-19 within the radius identified in the policy.

For the Prevention of Access / Hybrid Clauses, the Supreme Court held that business interruption losses are covered only if the losses 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 effects of the COVID-19 pandemic did not exclude them from cover.

Trends Clauses

Trends Clauses provide for business interruption loss to be quantified by reference to what the performance of the business would have been had the insured peril not occurred. All the sample policy wordings considered by the Supreme Court contained Trends Clauses. Such clauses are part of the standard method used in insurance policies that provide business interruption cover for quantifying the policyholder's financial loss. All of the insurers who appealed did so on the issue of how the Trends Clauses applied in the circumstances of the present case. Specifically, the insurers argued that the Trends Clauses meant that the insurers were not liable to indemnify policyholders for losses which would have arisen regardless of the operation of the insured perils by reason of the wider consequences of the COVID-19 pandemic.

The Supreme Court concluded that Trends Clauses 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.

Pre-Trigger Losses

At first instance, when considering the Trends Clause, the High Court held that the proper operation of the Trends Clause required consideration to be given to whether there was a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered. If there was, then in principle the continuation of that measurable downturn and/or increase in expenses could be taken into account as a trend affecting the business in calculating the loss.

The Supreme Court disagreed with this conclusion. It was found that the trends or circumstances for which adjustments may be made do not include trends or circumstances caused by the insured peril or its underlying or originating cause. This flows directly from the Supreme Court's conclusions on the operation of Trends Clauses.

The Orient Express Decision

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 their arguments on causation of loss and the effects of Trends Clauses.

Orient-Express concerned a claim for business interruption loss arising from damage to a hotel in central New Orleans from wind and water as a result of Hurricanes Katrina and Rita in the autumn of 2005. The insurance policy, which was governed by English law, provided cover against physical damage to the property on an "all risks" basis. It also provided cover for loss due to interruption or interference with the business "directly arising from Damage". The trends clause was in similar terms to those in the present case and provided that the adjusted figures "shall represent as nearly as may be reasonably practicable the results which but for the Damage would have been obtained during the relative period after the Damage".

There was no dispute in *Orient-Express* as to cover for the physical damage to the hotel caused by the hurricanes. However, Hamblen J accepted the insurers' argument that the cover did not extend to business interruption losses which would have been sustained even if the hotel had not been damaged, as the business interruption losses would have been suffered as a result of the extensive damage caused by the hurricane to the city of New Orleans. Accordingly, the necessary causal test for the business interruption losses could not be met because the insured peril was the damage alone, and the event which caused the insured physical damage (the hurricanes) could be viewed as a competing cause of the business interruption.

In the test case, the Supreme Court concluded that the High Court in *Orient-Express* had been wrong to hold that business interruption loss was not covered by the insuring clause as it did not satisfy the casual test. This is consistent with the Supreme Court's findings on causation, discussed above. The Supreme Court took the view that when the insured peril (damage to the hotel) and uninsured peril (damage to the rest of the city) operate concurrently and arise from the same underlying fortuity (the hurricanes), the loss arising from both causes should be covered.

The Supreme Court therefore determined that *Orient-Express* 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*."

Commentary

The Supreme Court's findings are favourable for policyholders who were ordered to close

their business premises during the March 2020 COVID-19 lockdown and wish to claim from their insurers. Policyholders should consider revisiting their policies to assess the impact this decision has on their coverage position.

For further information, please contact Georgina Squire or the Partner with whom you usually deal.