NO LONGER "BUSINESS AS USUAL" IN THE AGE OF COVID-19 – WHEN WILL BUSINESS INTERRUPTION INSURANCE RESPOND?

A Guidance Note from the 2TG Commercial and Insurance Teams

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Introduction

The calamitous arrival of Covid-19 and the restrictions imposed by governments and other authorities have led to many businesses looking at whether they have Business Interruption (BI) cover and, if so, whether they can successfully claim under their policies. The average businessman might think that insurers of such policies should simply pay out when his business has had to close or been disrupted. This is a common misconception of how BI insurance may respond. It is necessary to look more closely at the wording of the particular policy to see whether there is coverage and, if so, the extent of such coverage. In this Note I will look at coverage under the three main types of BI insurance, some defences that insurers may deploy and the response of the Financial Conduct Authority.

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Main types of BI insurance

The most common form of BI insurance taken out in the UK is one that is added on to a material damage property policy or after a material damage section in a policy. This is often found in the commercial combined insurance taken out by many medium and small businesses and firms (SMEs). These policies provide that the property insured has to have sustained physical loss or damage due to an insured event and interruption to the insured's business as a result of that physical loss or damage. The typical way in which these policies respond is where business premises may have been damaged by fire or flood and then have been unable to carry on producing or selling their goods for some time. Insurers under the material damage section will cover damage to the premises, equipment, stock etc. The BI cover is there to protect the insured usually for a fixed period against the financial losses consequent upon such damage, such as loss of profits or additional costs of working.

Depending on the wording, it is difficult to see that this type of BI insurance will be found to respond if there has been no physical damage to property belonging to the insured. Physical damage is generally construed by English courts as requiring physical alteration or change in the characteristics of the property. Nevertheless, it should be noted that it has already being contended in proceedings in Louisiana led by the Oceana Grill restaurant against Lloyd's Underwriters that contamination of the premises by Covid-19 amounts to a direct physical loss needing remediation to clean the surfaces of the establishment (see *Cajun Conti LLC et al v Lloyd's Underwriters No.2020-02558 (LA. Dist.Ct, Orleans Parish).*

Insureds may refer to certain cases under English law where courts have been prepared to find physical damage by contamination, such as *Losinjska Plovidba v Transco Overseas Ltd (The Orjula)* [1995] 2 Lloyd's Rep.395 at 398-399. In that case Mance J. considered that temporary contamination with hydrochloric acid amounted to property damage where the acid had to be washed off deck with a soda solution by specialist cleaners, even though there was no apparent corrosion or physical damage to the deck. There have been cases involving contamination by radioactive materials where sometimes the courts have been prepared to find that physical damage has occurred. By way of example, in *Blue Circle Industries Plc v Ministry of Defence* [1999] Ch289 it was found that topsoil contaminated with radioactive materials constituted property damage under the Nuclear Installations Act 1965. Those cases may be fairly easily distinguished as they did not involve BI insurance and their facts are very different to those relating to Covid-19.

A second type of BI insurance is Contingency Business Insurance ("CBI") which is sometimes bought as an extension to BI insurance policies, particularly by those involved in supply chains. This insurance invariably requires physical damage to others' properties, such as those of suppliers and customers. This form of insurance is designed to protect the insured against the financial consequences of disruption of supplies.

The third main type of BI insurance is that which does not require there to have been physical damage. Such BI insurance may appear in "stand alone" policies but are often found as extensions of cover to other policies. This insurance may cover the risk of business closure or disruption due to outbreak of disease, loss of access or state intervention. Under these BI insurance policies the trigger of cover will be defined by reference to the event itself.

"Disease"

Some BI policies are worded to provide cover for the business being interrupted due to infectious or communicable disease. It would be rare to find a policy which just refers to "any disease". Most list the particular diseases covered. Obviously Covid-19 would not come within a list of particular diseases in policies written prior to this Spring.

Some policies specifically provide that insurers may indemnify in respect of interruption or interference with the business following an occurrence or manifestation of a "notifiable disease". The policies usually go on to define notifiable disease further, for example, as some human infectious or contagious disease, an outbreak of which the competent public authorities have stipulated shall be notified to them. Covid-19 only became a "notifiable disease" in the UK on 5 March 2020 by a statutory instrument which added Covid-19 to the list of notifiable diseases under the Health Protection (Notification) Regulations 2010. Thus, cover for Covid-19 as a "notifiable disease" is only likely to be considered triggered from 5 March 2020. The case of *New World Harbourview Hotel Co Ltd v ACE* [2012] HKEC 264 provides a helpful illustration. The Claimant in that case had extended BI cover for, amongst other matters, "infectious or contagious disease occurring on the Premises or of notifiable human infectious or

contagious disease occurring within 25 miles of the Premises." The Claimant's business had been seriously disrupted by an outbreak of SARS in Hong Kong but had no incident of SARS on its premises. The Court of Final Appeal in Hong Kong decided that SARS only became an insured peril triggering cover when it was added to an Ordinance of 27 March 2003 making it a mandatory requirement to notify SARS to the authorities.

Some policies do not require the listed disease or notifiable disease to have been actually present in the business premises, stock or equipment etc themselves, as illustrated by the last case. These policies may be triggered by occurrence or manifestation of a notifiable disease within a radius of 1 mile or sometimes 25 miles of the business premises. It may be difficult to show that there was an occurrence of a notifiable disease within a radius of 1 mile in a rural area, but if the premises are in the middle of London it should be possible to demonstrate from data regarding the prevalence of Covid-19 that from at least early in March 2020 there were multiple occurrences of Covid-19 within a radius of 25 miles.

Loss of access/closure of business

Some policies provide specific coverage for such matters as loss of access to the business or for state intervention causing closure of the business. There are also policies which express their cover as being for inability to use the insured's premises or facilities "due to restrictions imposed by a public authority." These types of policies may be triggered when, for example, the UK Government directed on 20 March 2020 that all restaurants and pubs had to be closed due to the spread of Covid-19.

Under a typical BI policy the insured is entitled to recover for defined financial losses which the insured has suffered in the indemnity period, which is a set period, often 12 months, which runs from the date of the occurrence of the peril insured against, as defined by the policy. By way of example, if the BI policy provides that cover is against the business being required to be closed by order of the government, then it will be triggered from the date that the business is so closed pursuant to that order for a period of 12 months.

Main defences that may be raised by BI insurers:

Construction of the wording in relation to coverage

There are already many arguments being raised as to how particular policies should be construed. Of course, the starting point is to construe the actual words in the policy itself beginning with the insuring clauses and looking at them in the context of the policy as a whole. Often it is the insured who contends that a purposive approach should be taken in construing insurance coverage. In the present circumstances, however, it may be the insurers who wish to raise a purposive construction on the basis that at the time the insurance was entered into, neither party had known about Covid-19 and it was not intended for the insurance to cover pandemics such as this.

Insurers have a strong defence where insurers have set out in the policy a list of "defined diseases" which are covered, as obviously Covid-19 will not have been listed in the past. Insurers may be on a less surer footing to mount an effective defence where the policy covers disruption caused by "any disease" or "by State intervention" or "loss of access". Of course, those insurers who had the foresight to exclude pandemics in their policies are sitting tight and relying on the wording of their exclusion.

Causation

If the policy is construed as providing cover for a BI related claim, an insurer may still raise other defences based on causation. If the trigger for the loss is occurrence of an insured peril giving rise to material damage under a typical property policy, it has to be shown that the BI loss was the result of material or physical damage. It is usually necessary for the insured to prove that the loss was proximately caused by the material damage itself I

explained earlier that it will be very difficult for a policy holder to prove physical damage to property. In the present circumstances insurers will decline indemnity on the basis that the BI loss was not caused by physical damage, but by other causes, for example, an insurer of a cinema would defend on the basis that there was no BI loss due to physical damage to the cinema and that, in any event, the cause of the cinema's BI losses was the Government's decision ordering it to be closed on 20 March 2020 or the cinema's own decision to close on an earlier date.

In those policies which are not dependent on demonstrating physical damage, there may still be arguments on causation. By way of example, a policy may cover a clothing store for disruption or closure by State intervention which means that *prima facie* the policy is triggered by the government ordering closure due to Covid-19 on 23 March 2020. Nevertheless, it may be contended by insurers that the business's loss of profits was largely due to mismanagement or pre-existing financial difficulties rather than the Government's decision that shops selling non-essential items should be closed.

The case of *IF P&C Insurance Ltd v Silversea Cruises* [2004] EWCA Civ 769 which reached the Court of Appeal provides some guidance as to the likely approach of the courts. Silversea, a cruise company, had insurance cover, which amongst other things, covered loss of "anticipated income" expected to be earned on future cruises up to a certain date. That insurance covered loss resulting

> "from a State Department Advisory or similar warning by competent authority regarding acts of war, armed conflict … terrorist activities, whether actual or threatened, that negatively impacts the Assured's bookings and/or necessitates a change to the scheduled cruise itinerary".

Most of Silversea's clients came from the USA. Silversea s claim under this cover was based on loss of business following the attacks of 9/11 and subsequent US government warnings about travelling. Many clients cancelled their bookings with Silversea and additionally the number of anticipated bookings for future cruises did not go ahead. The judge found that deterioration in Silversea's market was directly caused by the warnings and the 9/11 attacks. The Court of Appeal accepted that that cover was concerned with the immediate consequence of the insured perils upon the operation of the assured's ships and not with commercial decisions taken by Silversea following the occurrence of those perils, such as Silversea laying up one of its ships and diverting others. Silversea succeeded against insurers, but did not recover as large an amount of anticipated income as it claimed to have lost.

Quantum generally

Much time and money are often expended on arguing about the quantum of BI claims, usually between loss assessors on behalf of the insured and loss adjusters on behalf of insurers. This tends to escalate if there is little consensus between the parties and lawyers are engaged. In straightforward cases where there is an indemnity period of 12 months following the triggering peril, the calculation of profits is focused on the loss of profits for the 12 months preceding the occurrence of the peril as the comparator. Sometimes there is a "Trends clause" in the policy which allows trends and variations before and after the indemnity period to be taken into account in assessing loss of profits. A typical Trends clause states:

> "Adjustments shall be made as may be necessary to provide for the trend of the Business and for variations in or special circumstances affecting the Business either before or after the Damage or which would have affected the Business had the Damage not occurred so that the figures thus adjusted 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."

This type of clause usually leads to arguments being mounted not only as to the likely trend of the business itself, but also allows variations and special circumstances affecting the business to be taken into account both before or after the triggering event. One often finds both parties mounting arguments about how far external economic and market issues may have affected a business's profitability. Insurers are likely to point to external factors which happened after the triggering event which, in any event, would have reduced the likely profits that the business would have made.

The FCA's position

There has been much discussion in the insurance market and the press about the extent to which BI insurers should respond to Covid-19 related claims. Appeals were made to the Financial Conduct Authority (FCA) to intervene. On 15 April 2020 the FCA wrote a letter to CEOs of UK insurers directed at BI insurance for SMEs, which stated that:

> "Based on our conversations with the industry to date, our estimate is that most policies have basic cover, do not cover pandemics, and therefore would have no obligation to pay out in relation to the COVID-19 pandemic. While this may be disappointing for the policyholder we see no reasonable grounds to intervene in such circumstances."
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> "In contrast, there are policies where it is clear that the firm has an obligation to pay out on a policy. For these policies, it is important that claims are assessed and settled quickly."

On 1 May 2020 the FCA announced that it would be taking court action to seek a declaration as to the meaning and effect of different BI wordings where there is uncertainty as to their interpretation. The FCA is seeking a declaration in respect of a relevant sample of wordings which do not require physical damage to the insured's property. The FCA entered into a framework agreement with certain insurers as to how such a test case should proceed. On 9 June 2020 the FCA started proceedings under the Financial Markets Test Case Scheme against six insurers and two managing agents in relation to sample wordings. The FCA is adopting the policyholders' position for the purposes of this action. It is anticipated that a hearing will take place in the Commercial Court in the latter half of July 2020, starting on 20 July. It is commendable to see how quickly this litigation has been brought to court as a result of co-operation between the FCA and insurers.

Resolution of claims

Battle lines are being drawn up by insureds against their BI insurers. Some UK insureds are banding together for potential group actions, such as those led by Media Zoo against Hiscox, and the Hospitality Insurance Action Group against other leading UK insurers. The FCA has stated that it is seeking an authoritative declaration on various wordings to give some clarity for insureds and insurers. This will provide some assistance but will not resolve all disputes. There will still be arguments about coverage in some cases and, even where coverage is resolved, there is likely to be disputes about quantum, aggregation and issues that are only of individual or specific application. The legal and compensatory fall-out of Covid-19 will be before judges, arbitrators, mediators and the Financial Ombudsman Service for years to come.

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Alison specialises in commercial law, in particular insurance and reinsurance law. She has been instructed by the Corporation of Lloyd's, major insurance and reinsurance companies, as well as by insureds and brokers. She has advised on a vast variety of insurance covers and risks. She has drafted policy wordings and provided evidence for foreign courts on English insurance law. She has advised and appeared in many cases involving BI insurance, including an arbitration relating to a major luxury hotel.

Alison sits as an arbitrator and mediator. She has regularly chaired professional conferences on insurance and reinsurance law. She is a Vice President of the British Insurance Law Association and Chair of its Charitable Trust.

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