COVID-19 BUSINESS INTERRUPTION CLAIMS - THE CORRECT ORIENTATION EXPRESSED

A Note from the 2TG Insurance Group

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***The Financial Conduct Authority v Arch Insurance (UK) Ltd and others* [2021] UKSC 1**

1. On Friday, 15 January 2021, the Supreme Court handed down judgment in the FCA COVID-19 Business Interruption ("BI") test case.

The Judgment

2. The Supreme Court dismissed the Insurers' appeals and substantially allowed the FCA's appeal from the decision of the Financial List [2020] EWHC 2448 (Comm).

3. The majority judgment was given by Lord Hamblen and Lord Leggatt (with whom Lord Reed agreed). A separate concurring judgment was given by Lord Briggs (with whom Lord Hodge agreed)

The Facts

4. The Court considered whether a variety of insurance policy wordings cover BI losses arising from the COVID-19 pandemic.

5. Although most of the judgment dealt with the construction of the sample policy wordings in BI claims, the court's comprehensive analysis of causation is relevant to all insurance claims and arguably to breach of contract and tort claims generally.

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The issues

6. The Supreme Court considered six issues: –
   (i) The proper interpretation of "disease clauses";
   (ii) The proper interpretation of "prevention of access clauses" and "hybrid clauses";
   (iii) Causation – in particular the necessary causal link which had to be established between the BI losses and the insured peril (in this case the occurrences of a notifiable disease);
   (iv) The effect of "trends clauses";
   (v) "Pre-trigger losses"; and
   (vi) The status of the decision of the Commercial Court in *Orient-Express Hotels Ltd* v *Assicurazioni Generali SpA (trading as Generali Global Risk)* [2010] EWHC 1186 (Comm) ("Orient-Express") [2010] Lloyd's Rep IR 531.

The reasons

Disease clauses

7. "Disease clauses" are clauses which provide cover for BI losses resulting from the occurrence of a notifiable disease (such as COVID-19) at or within a specified distance of the business premises.

8. A typical clause is the RSA 3 wording: –
   "We shall indemnify you in respect of interruption or interference with the Business during the Indemnity Period following:
   a. any
   i. occurrence of a Notifiable Disease (as defined below) at the Premises…
   iii. occurrence of a Notifiable Disease within a radius of 25 miles of the Premises."

9. The Court held, applying the well-known House of Lords and Supreme Court cases on contractual interpretation, that the disease clause in RSA 3 is properly interpreted as providing cover for BI loses caused by any cases of illness resulting from COVID-19 that occur within a radius of 25 miles of the premises from which the business is carried on. It does not cover interruption caused by cases of illness resulting from COVID-19 that occur outside that area. (See judgment at [74], [95]).

10. Lord Briggs (with whom Lord Hodge agreed) said an alternative construction of the disease clause is that COVID-19 as a whole falls within the insured perils once it spreads within the specified radius.

11. The Court also dismissed as having "no merit" RSA's argument that, by reason of a general condition in the RSA policy which stated there was no cover for loss caused by "disease or epidemic", the "disease clause" only applies if the disease is not also part of an "epidemic". The Court considered that it was "as unreasonable as it was unrealistic" to suggest that a policyholder would have read the general condition in the policy and understood it to have been removing a substantial part of the cover for BI loss that was otherwise in place by reason of the disease clause (see [75] – [80]).

12. The Court concluded that only an occurrence of a notifiable disease at the insured premises or within the specified area constituted an insured peril. It stated that the words "occurrence" of a notifiable disease in a disease wording referred to an occurrence of illness sustained by a person at a particular time at a particular place and in a particular way (see also [199]).

Preventing access and hybrid clauses

13. The Court also considered "Prevention of access" clauses and "Hybrid clauses"; the former being clauses which provide cover for BI losses resulting from public authority intervention preventing or hindering access to, or use of, the business premises, the latter being clauses which combine the main elements of the 'disease' and 'prevention of access' clauses.

14. The Court held that the public authority intervention preventing or hindering access to the business premises does not need to have the force of law and can include government or public authority instructions which do not have the force of law but do have a mandatory quality and carry an expectation of compliance. For example, an intervention which would trigger cover can include the Prime Minister's instructions to "stay at home" prior to any equivalent regulations/statutory instruments coming into effect.

"*Restriction imposed*"

15. A "restriction imposed" can be imposed on potential customers of the insured business, and not just the policyholder and/or its use of the insured premises. [125] – [128]

"*Inability to use*"

16. The "inability to use" the business premises may include a policyholder's inability to use either the whole or a discrete part of its premises either for the whole or a discrete part of its business activities. [129] – [145]

"*Prevention of access*"

17. "Prevention of access" may include prevention of access to a discrete part of the premises or to the whole part of the premises for the purpose of carrying on a discrete part of the policyholder's business activities. [146] – [156]

"*Interruption*"

18. "Interruption" means "business interruption generally" and includes interference or disruption, and is not limited only to a complete cessation of the policyholder's business or activities.

Causation

Disease clauses

19. On the proper interpretation of the disease clauses, the question of what connection must be shown between any such cases of disease (within the specified radius of the premises) and the business interruption loss for which an insurance claim is made, is critical.

20. The court analysed the law on proximate causation, concurrent causes, and the 'but for' test.

21. The 'but for' test of causation was said sometimes to be inadequate as there can be situations (as here) 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.

22. The majority said:-
"For these reasons there is nothing in principle or in the concept of causation which precludes an insured peril that in combination with many other similar uninsured events brings about a loss with a

sufficient degree of inevitability from being regarded as a cause - indeed as a proximate cause - of the loss, even if the occurrence of the insured peril is neither necessary nor sufficient to bring about the loss by itself." [191]

23. In analysing the causal link in the disease cases, the right question to ask is: –
"...did the insured peril cause the business interruption losses sustained by the policyholder within the meaning of the causal requirements specified in the policy?" [192]

24. The majority rejected the insurers' contention that the occurrence of one or more cases of COVID-19 within the specified radius cannot be a cause of business interruption loss, if the loss would not have been suffered 'but for' those cases because the same interruption of the business would have occurred anyway as a result of other cases of COVID-19, elsewhere in the country.

25. In other words, the radius provisions do not limit cover to a situation where the BI was caused only by cases of disease occurring within an area, as distinct from other cases outside the area.

26. The majority concluded:-
"...on the proper interpretation of the disease clauses, in order to show that loss from interruption of the insured business was proximately caused by one or more occurrences of illness resulting from COVID-19, it is sufficient to prove that the interruption was a result of Government action taken in response to cases of disease which included at least one case of COVID-19 within the geographical area covered by the clause." [212]

Prevention of access and hybrid clauses

27. In the Hiscox clause, the elements of the insured peril, in their correct causal sequence are:-
(A) an occurrence of a notifiable disease, which causes
(B) restrictions imposed by a public authority, which cause
(C) an inability to use the insured premises, which causes
(D) an interruption to the policyholder's activities that is the sole and direct cause of financial loss.

28. The majority concluded:
"The conclusion we draw is that, properly interpreted, the public authority clause in the Hiscox policies indemnifies the policyholder against the risk (and only against the risk) of all the elements of the insured peril acting in causal combination to cause business interruption loss; but it does so regardless of whether the loss was concurrently caused by other (uninsured but non-excluded) consequences of the COVID-19 pandemic which was the underlying or originating cause of the insured peril.

This interpretation, in our opinion, gives effect to the public authority clause as it would reasonably be understood and intended to operate. For completeness, we would point out that this interpretation depends on a finding of concurrent causation involving causes of approximately equal efficacy. If it was found that, although all the elements of the insured peril were present, it could not be regarded as a proximate cause of loss and the sole proximate cause of the loss was the COVID-19 pandemic, then there would be no indemnity. An example might be a travel agency which lost almost all its

business because of the travel restrictions imposed as a result of the pandemic. Although customer access to its premises might have become impossible, if it was found that the sole proximate cause of the loss of its walk-in customer business was the travel restrictions and not the inability of customers to enter the agency, then the loss would not be covered." ([243]-[244]).

Trends clauses

29. "Trends clauses" provide for BI losses to be quantified by reference to what the performance of the business would have been had the insured peril not occurred.

30. An example of a standard method of quantification:-
"... takes an earlier period of trading for comparison purposes. In most wordings this is the calendar year preceding the operation of the insured peril. A "standard turnover" or "standard revenue" is derived from the turnover of the business in this period. This figure is then compared with the actual turnover or revenue during the indemnity period. The results of the business in the comparator period are also used to derive a percentage of turnover that represents gross profit. The rate of gross profit is then applied to the reduction in turnover to calculate the recoverable loss. Increase in the cost of working during the indemnity period is also typically covered."

31. However, the 'trends clause' takes into account the trend of the business:-
"Whilst the basic comparison between the turnover of the business in the prior period and in the indemnity period will produce a rough quantification of the lost revenue, there may be specific reasons why a higher or lower figure would be expected for the indemnity period apart from the operation of the insured peril. For example, the general trend in the business may be such as to make it likely that there would have been increased or decreased turnover during the indemnity period in any case compared with the previous year. Equally, there may be specific reasons why the turnover during the prior year was depressed, such as a strike that affected the business, or why it would be expected to have been depressed anyway during the indemnity period, such as a scheduled strike. The purpose of the trends clause is to provide for adjustments to be made to reflect "trends" or "circumstances" such as these. The aim is to achieve a more accurate figure for the insured loss than would be achieved merely by a comparison with the prior period and to seek to arrive at a figure which, consistently with the indemnity principle, is as representative of the true loss as is possible. The adjustment may work in favour of either the policyholder or the insurer, but it is meant to be in the interests of both." ([254])

32. The Court emphasised that trends clauses are meant to address losses wholly outside the insured peril and should be construed consistently with the insuring clause.The majority said the trends clause "*should be construed so that the standard turnover or gross profit derived from previous trading is adjusted only to reflect circumstances which are unconnected with the insured peril and not circumstances which are inextricably linked with the insured peril in the sense that they have the same underlying or originating cause. Such an approach ensures that the trends clause is construed consistently with the insuring clause, and not so as to take away cover prima facie provided by that clause.*" [287]

Pre-trigger losses

33. The Court addressed the question of whether any BI loss awarded should be reduced to account for a downturn in turnover of the business due to COVID-19 which would have continued even if cover had not been triggered by the insured peril.

34. On this, the majority said:-
"Accordingly, we consider that the court below was wrong to hold that the indemnity for business interruption loss sustained after cover was triggered should be reduced to reflect a downturn in the turnover of the business due to COVID-19 which would have continued even if cover had not been triggered by the insured peril. The court had correctly concluded that losses should be assessed on the assumption that there was no COVID-19 pandemic. Consistently with that conclusion, the court should have held that, in calculating loss, the assumption should be made that pre-trigger losses caused by the pandemic would not have continued during the operation of the insured peril." [296]

The Orient-Express case

35. The decision in *Orient Express* will be familiar to many insurance practitioners. In that case, a Tribunal held that the recoverable damage to the business of a hotel which was damaged by a hurricane did not extend to BI loss which the hotel would have suffered anyway as a result of damage to the wider city caused by the same hurricane.

36. The Supreme Court held that the *Orient Express* case was wrongly decided and should be overruled.

37. Lord Leggatt (as George Leggatt QC) was a member of the arbitral tribunal in the *Orient-Express* case. Lord Hamblen (as Hamblen J) was the judge who decided the appeal in the Commercial Court.

38. After citing Justice Jackson in the US Supreme Court, Lords Leggatt and Hamblen invoked whatever ways by which we may *"gracefully and good naturedly"* surrender *"former views to a better considered position."*

Financial Markets Test Case Scheme

39. The case was heard under the Commercial Court's "Financial Markets Test Case Scheme".

40. The majority said: –
"It is a testament to the success of the Test Case Scheme procedure that it will have enabled the important legal issues raised in this case to be finally decided following a trial and an appeal to the Supreme Court in just over seven months. It is hoped that this determination will facilitate prompt settlement of many of the claims and achieve very considerable savings in the time and cost of resolving individual claims." [43]

Conclusions

41. This landmark judgment will be the first port of call in assessing COVID-19 BI claims and BI claims generally.

42. We expect that the illuminating analysis of causation will be cited not only in relation to insurance claims but also in contract and tort claims generally. Only time will tell whether parties and the lower courts will see the decision as an invitation to move

away from 'but for' causation in other factual scenarios.

43. The judgment also provides helpful guidance regarding the Court's approach to construing insurance clauses. In particular, the Supreme Court emphasised at various points in the judgment that one should interpret words in a way consistent with commercial sense or commercial intent (see, for example [133,136, 152,195, 227-228]).

44. We expect that many insurers will be considering how they might wish to amend clauses or redraft their BI wordings in the light of the Supreme Court's decision.

45. The decision will likely come as a welcome relief to many small to medium sized businesses who took out BI policies and have suffered during the pandemic. That said, insureds will still need to consider carefully the particular wording of their policy of insurance, and whether their particular situation falls within the interpretations set out by the Supreme Court. Whilst the guidance given by the Supreme Court is wide-ranging, it will by no means cover all scenarios and policy wordings, and more decisions relating to COVID-19 losses are expected.

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