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# Analysis of UK Supreme Court's Decision in FCA Test Case

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Described by the UK's Financial Conduct Authority (FCA) as *"probably the most important insurance decision of the last decade"*, the recent decision of the UK's highest court in the business interruption insurance test case is likely to result in many thousands of UK businesses receiving indemnities from their insurers for business interruption losses experienced as a result of COVID-19. While it is good news for policyholders, it is a disappointing outcome for the insurance industry. (Read our previous update here)

It is estimated that, in addition to the particular policies ruled upon in the test case, 700 types of policies across over 60 different insurers and held by 370,000 UK policyholders, are affected by the decision. This is estimated to equate to approximately £1.2 billion in claims. It is also expected that the UK Financial Ombudsman Service and courts in Scotland and Northern Ireland will be guided by the decision in ruling on other similar cases. The UK Supreme Court's decision may also be important for insurers and policyholders in Ireland. The Irish High Court recently deferred delivering its decision in the business interruption insurance test case brought by four publicans against FBD Insurance in order to allow the parties to make submissions on the UK Supreme Court decision. The Irish High Court's decision is now due to be delivered on 5 February 2021.

### Background to the decision of the English High Court and the UK Supreme Court Appeal

The FCA, representing the interests of policyholders (mostly SMEs), brought a test case against eight of the leading providers of business interruption insurance in the UK. Two action groups also participated in the case as "interveners", on behalf of policyholders. The purpose of the test case was to obtain the UK High Court's determination on issues relating to the validity and interpretation of business interruption insurance policies. This was to assist policyholders and insurers to resolve disputes arising out of claims for business interruption losses caused by COVID-19.

The High Court found substantially in favour of the FCA before six of the eight insurers appealed the High Court's decision. The FCA also appealed on four issues on which it had been unsuccessful as it feared the High Court's finding on these issues would present obstacles for many policyholders seeking indemnities from their insurers. The Hiscox Action Group appealed on similar grounds to the FCA.

The Supreme Court rejected all of the insurers' appeals (despite agreeing with some of their arguments). It allowed the appeals by the FCA and the Hiscox Action group (with some qualifications).

### Analysis of UK Supreme Court decision

The decision clarifies issues of interpretation, causation and quantification of loss which are critical to decisions on the validity of business interruption clauses.

#### Headline Points

**Disease clauses:** Policyholders are likely to recover under these clauses if they show that at the time of a particular government measure, there was at least one case of COVID-19 within the geographical area covered by the clause.

**Prevention of access:** Insurers will be required to indemnify losses of affected businesses from the dates on which the UK government gave instructions to those businesses to close (provided those instructions satisfy certain conditions), and not from the later dates on which relevant laws came into force.

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**Prevention of access/inability to use:** Policyholders should now be able to recover for losses incurred as a result of being unable to use part of their premises or being unable to carry out part of their business activities. A complete shutdown of a business will not be required to trigger cover.

**Causation:** The "but for" test is not always appropriate, particularly, in situations like the COVID-19 pandemic, when a number of issues (such as the disease, government measures) combined to cause loss. The Supreme Court's decision on causation will see business interruption policies being more likely to provide cover in "wide area damage" situations such as storms and floods.

**Trends clauses:** Insurers cannot reduce indemnities on the premise that much of the loss suffered by policyholders would have occurred in any event, even without their cover having been triggered, due to the effects of COVID-19 generally.

**Pre-Trigger Losses:** In calculating loss, it should be assumed that pre-trigger losses caused by COVID-19 would not have continued during the operation of the insured peril. This will result in higher indemnities being paid.

**The Orient-Express decision:** The Supreme Court held that the decision of the UK Commercial Court in the "Orient-Express" case was wrongly decided.

### *Disease clauses*

The Supreme Court considered a number of clauses which provide cover for business interruption caused by an occurrence of a notifiable disease at or within a specified radius of a policyholder's premises (usually 25 miles). The High Court had agreed with the FCA's interpretation of these clauses. Four of the insurers appealed against the High Court's interpretation.

The Supreme Court accepted the insurers' arguments that (i) each case of illness sustained by a person as a result of COVID-19 is a separate "occurrence" and (ii) this type of clause only covers business interruption losses caused by cases of COVID-19 that occur within the specified radius. However, because of its views on causation, the UK Supreme Court said that this did not mean that the cover provided should be confined to business interruption which results only from cases of the disease within the radius, as opposed to cases elsewhere. This nuance is important and means that although the Supreme Court construed disease clauses more narrowly than the High Court, its interpretation did not change the outcome of the High Court's decision, and as such, policyholders are still likely to recover under these clauses.

### *Prevention of acess and hybrid clauses*

These clauses tend to refer to a business being unable to use its premises due to restrictions imposed by the government following an occurrence of an infectious or contagious disease. The Supreme Court agreed with the High Court that the insured peril is a composite one and all elements of the clause must be satisfied to trigger the insurer's obligation to indemnify the policyholder. One of the issues on appeal was the required causal link between each of the elements. The Supreme Court held that the elements must occur in a causal sequence i.e. (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.

The parties appealed the High Court's interpretation of the various elements of these clauses.

#### Prevention of access

The FCA and the Hiscox Action Group appealed the High Court's interpretation of *"prevention of access"* and *"inability to use"* as meaning that cover would not be triggered for such perils unless a business was forced to shut completely.

The Supreme Court considered that *"prevention"* or *"denial"* of access means something is stopped from happening or becomes impossible. However, it held that a total closure of a business or premises is not required to trigger cover, a partial closure may be sufficient. It said if there was a prevention or denial of access to a discrete part of a premises or one which prevented the carrying on of a discrete part a policyholder's business activities, it would be covered.

The Supreme Court held that a clause covering an "inability to use" would be satisfied if there was an *inability* to use, as opposed to a disruption, impairment or hindrance in use. In this respect, it agreed with the High Court. However, similar to the above, it held that the requirement would be satisfied if a policyholder was unable to use its premises for a discrete part of its business activities or if it was unable to use a discrete part of its premises for its business activities.

Some examples are perhaps helpful to show the effect of this in practice: a restaurant that had to close to the public for the purpose of indoor dining, but which was allowed to continue its takeaway service, or a golf course that was allowed to remain open but which had to close its clubhouse, could now both recover under these types of clauses.

#### Restrictions imposed

The FCA and Hiscox Action Group appealed the High Court's decision that a policy providing cover for loss caused by *"restrictions imposed"* by the government will not be triggered unless the restrictions were imposed by way of statutory instrument. The Supreme Court allowed this appeal. It held that the phrase *"restrictions imposed"* does not necessarily require a measure that has the force of law. It could also include an instruction given by a public authority in mandatory terms where it is clear enough to the addressee, from the terms and context, that compliance with it is required, and would reasonably be understood to be required, without the need for recourse to legal powers. The Supreme Court agreed with the FCA that phrases such as *"closure or restrictions placed on a premises"* and *"enforced closure"* could be interpreted similarly.

This is significant because it means that insurers will be required to indemnify losses of affected businesses from the dates on which the UK government gave instructions to those businesses to close (provided those instructions satisfy the conditions above) and not from the later dates on which relevant laws came into force.

#### Interruption

Hiscox appealed against the High Court's interpretation of *"interruption"*, arguing that it requires a stop or break to business. The Supreme Court rejected this argument and said *"interruption"* could encompass interference or disruption and it did not require a complete cessation of business.

The Supreme Court's interpretation of these clauses was wider than the High Court's. More UK policyholders will benefit as a result of this new interpretation.

### *Causation*

The appeal raised a number of issues in relation to causation. The insurers argued that the policyholders would have suffered the same or similar business interruption losses even if the insured risk or peril had not occurred due to the widespread effects of COVID-19, and so their claims must fail because it cannot

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be said that their loss was caused by the insured peril, i.e. even if a premises had not been forced to shut, the turnover of the business would have been negatively affected by other public health measures. The focus of the insurers' argument was that policyholders could not satisfy the "but for" test and therefore, the insured peril was not the legal cause of their loss.

In rejecting this argument, the Supreme Court explained that the "but for" test is sometimes inadequate and there are situations (such as the current one) where a series of events all cause a result although none of them on their own is either necessary or sufficient to cause the result by itself. The Supreme Court found there was nothing in the concept of causation which precludes an insured peril which brings about a loss, in combination with many other similar uninsured events, from being regarded as a proximate cause of the loss and from making the insurers liable (unless, one of the proximate causes of the loss is expressly excluded from cover under the policy).

It also agreed with the High Court that government measures had been taken in response to information about all the cases of COVID-19 in the country as a whole and that all the individual cases of COVID-19 which had occurred by the date of any government measure were equally effective "proximate" causes of that measure.

On the causation required in relation to disease clauses, the Court held that it would be sufficient for a policyholder to show that at the time of a particular government measure, there was at least one case of COVID-19 within the geographical area covered by the clause.

On the causation required when relying on prevention of access and hybrid clauses, it held that business interruption losses are covered only if they result from all the elements of the risk covered by the clause operating in the required causal sequence. However, the fact that such losses were also caused by other (uninsured) effects of the pandemic does not exclude them from cover under such clauses.

The Supreme Court appears to have therefore taken the view that the business interruption loss caused by COVID-19 has "concurrent causes" but in the absence of clauses excluding the uninsured consequences of the pandemic, it will be possible to establish causation.

***Trends clauses***

The insurers argued both at first instance, and on appeal, that in the context of business interruption caused by COVID-19, they could rely on trends clauses to reduce the amount of money payable to policyholders or to remove their liability to indemnify policyholders.

Trends clauses are used when quantifying a policyholder's loss. They are aimed at identifying what the financial results of a business would have been if the insured peril had not occurred. They tend to provide that the amount that the insurer will pay for loss of gross profit will be adjusted to reflect any special business trends or circumstances affecting the business so that the amount paid reflects as closely as possible the profits that would have been made if the insured peril had not occurred. As such, the objective of these clauses is to ensure that the policyholder is put in the same, and not a better (or worse), position than they would have been in had the insured damage not occurred.

Insurers argued that the trends clauses required the loss payable to policyholders to be reduced substantially or that it removed their liability because regardless of the occurrence of the insured perils (i.e. even if a premises had not been ordered to close), the wider consequences of the COVID-19 public health measures (such as government advice to the public to stay at home), would have caused the policyholder's losses.

This argument was rejected by both the High Court and the Supreme Court.

The Supreme Court emphasised, as the High Court had, that trends clauses are for quantifying loss and they do not delineate the scope of an indemnity (which is the function of insuring clauses). It said that trends clauses should, if possible, be construed consistently with insuring clauses. This means that unless a policy wording provides otherwise, the trends clauses should not be interpreted in a manner that takes away the cover provided by the insuring clauses as such an approach would be to treat them as an exclusion.

The Supreme Court's views on the application of trends clauses differed slightly from those of the High Court. In respect of disease clauses, it held that for the purpose of making adjustments under the trends clauses, parties must consider what financial results would have been achieved by the business during the indemnity period but for the occurrence of the insured peril, which in the case of disease clauses, was each case of the disease within the radius and circumstances arising out of the same underlying or originating cause as the insured peril. In this regard, it held that the "but for" causation test is suitable when interpreting trends clauses in the context of disease clauses.

In relation to the prevention of access and hybrid clauses, the Supreme Court said the "but for" test would not be suitable. Its approach to these trend clauses also differed from that of the High Court. It held that the parties should inquire into what the financial results of the insured business would have been if all the elements of the composite peril (in causal sequence) had not occurred and if circumstances arising out of the same underlying or originating cause as the peril had not occurred.

The Supreme Court concluded that trends clauses should generally be construed as requiring "trends or circumstances" related to the insured peril to be excluded when making adjustments to a policyholder's profits for the purpose of quantifying its loss.

The effect of this is very significant as it means that insurers cannot reduce indemnities on the premise that much of the loss suffered by policyholders would have occurred in any event, even without their cover having been triggered, due to the effects of COVID-19 generally.

***Pre-trigger losses***

The FCA and the Hiscox Interveners appealed against the High Court's decision that if there was a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered, or, if a business's costs increased, then it would be appropriate, when applying the trends clauses, to consider that the downturn or increase in costs would have continued. This decision meant the indemnities payable to policyholders would be reduced.

The Supreme Court allowed this appeal. It said that to reduce an indemnity to reflect a downturn in the turnover of a business, caused by the effects of the pandemic other than the insured peril, would be to refuse to indemnify the policyholder for loss proximately caused by the insured peril on the basis that the loss was also proximately caused by uninsured (but non-excluded) perils with the same originating cause. This was consistent with the approach it had taken to interpreting trends clauses generally.

The Supreme Court concluded that in calculating loss, it should be assumed that pre-trigger losses caused by COVID-19 would not have continued during the operation of the insured peril. This will result in higher indemnities being paid.

***Orient-Express***

The insurers sought to rely on the decision generally referred to as

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*"Orient-Express"* to bolster their case on causation. The High Court held that the decision should be distinguished from the present case but that if had not been distinguishable, it would have held that it had been wrongly decided. The Supreme Court went further and said it was wrongly decided.

The English Commercial Court in Orient-Express had found that an insurer was not liable for business interruption lossessuffered by a hotel in New Orleans after hurricane Katrina on the basis that the loss was not covered by the insuring clause as it did not satisfy the "but for" test. The business interruption loss arose both because (a) the hotel was damaged and (b) the surrounding area/other parts of the city were damaged. There were two concurrent causes of loss, each of which was by itself sufficient to cause the relevant business interruption but neither of which satisfied the "but for" test because of the existence of the other.

The Supreme Court stated that in such circumstances, when both an insured peril (i.e. in the Orient-Express case, damage to the hotel) and an uninsured peril (damage to the rest of the city) operate concurrently and arise from the same underlying fortuity (the hurricane), then provided that damage proximately caused by the uninsured peril is not excluded, loss resulting from both causes is covered.

Interestingly, two of the Supreme Court judges had been involved in the Orient-Express case (one as a member of the arbitral tribunal and the other as the judge in the appeal). However, the Supreme Court held that *"on mature and considered reflection"* the Orient-Express case was wrongly decided and should be overruled.

Since the Supreme Court delivered its judgment, the FCA has commented that the Court's decision to overrule the Orient-Express case has implications beyond COVID-19 insurance claims and will mean that business interruption policies will be more likely to provide cover in "wide area damage" situations such as storms and floods.

## What next?

The final stage in this litigation will be when the UK Supreme Court shortly publishes declarations on its decision which will bring further clarity and give greater guidance to affected parties. But do not expect this to be the last you will hear of this decision or the issues arising from it – it will have ramifications for future insurance litigation, both in the UK and elsewhere.

## KEY CONTACTS

### LITIGATION, DISPUTE RESOLUTION AND INVESTIGATIONS

**Joanelle O'Cleirigh**
Partner
+353 1 920 1650
joanelle.ocleirigh@arthurcox.com

**Richard Willis**
Partner
+353 1 920 1154
richard.willis@arthurcox.com

**Michael Twomey**
Partner
+353 1 920 1139
michael.r.twomey@arthurcox.com

**Deirdre O'Mahony**
Partner
+353 1 920 1058
deirdre.omahony@arthurcox.com

**Jamie Brislane**
Associate
+353 1 920 1471
jamie.brislane@arthurcox.com

**Sinead Reilly**
Professional Support Lawyer
+353 1 920 1151
sinead.reilly@arthurcox.com

### INSURANCE AND REINSURANCE

**Jennifer McCarthy**
Partner
+353 1 920 1167
jennifer.mccarthy@arthurcox.com

**Catherine Wolfe**
**Associate**
+353 1 920 1286
catherine.wolfe@arthurcox.com

**Nial Guinan**
**Associate**
+353 1 920 1682
naill.guinan@arthurcox.com

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