FCA business interruption insurance test case – Supreme Court judgment

A summary of the Supreme Court judgment in the FCA business interruption insurance test case

On 15 January 2021, the Supreme Court handed down its judgment in the leapfrog appeal of the FCA Business Interruption Insurance Test Case (a link to our summary of the judgment from the High Court can be found here). Although the lower court had largely found in favour of the FCA, both Insurers and the FCA appealed on various issues.

Executive Summary

The Supreme Court broadly accepted the FCA appeals (with some qualifications). Although it accepted some of the arguments made by Insurers, they ultimately concluded they did not affect the outcome of the appeal. Insurers' appeals were all dismissed. The outcome of this decision means that all insuring clauses that were being considered in the appeal will provide cover for losses caused by Covid-19 and these losses will not be reduced by reference to any Covid-19 related losses that occurred prior to policies being triggered. The case provides new law on issues of causation and overturns the, arguably insurer-friendly, decision in *Orient Express Hotels v Assicurazioni Generali SpA.*

The Supreme Court's decisions have effectively widened the scope of cover available to policyholders, applying an even broader interpretation than the already generous application of the High Court. It is anticipated that this decision could cover some 700 types of policies across over 60 different insurers, potentially affecting 370,000 policyholders.

The Judgment

The judgment totalled over 100 pages and provided detailed analysis on each of the issues on appeal. It should be reviewed carefully for a proper understanding of the conclusions reached by the Supreme Court and their reasons for doing so.

We set out below our summary of some of the main issues that were considered, which can largely be grouped as follows:

- Disease Clauses
- Prevention of Access / Hybrid Clauses Causation / 'but for' test
- Trends Clauses
- Pre-trigger losses
- The Orient Express Hotels Decision

The Supreme Court was asked to interpret the meaning of various insuring clauses. At the outset, it was noted that any policy must be interpreted objectively by asking what a reasonable person in the position of the insured, with all the background knowledge which would reasonably have been available to the parties when they entered into the contract, would have understood the language of the contract to mean. With that as its basis, the Court considered the following.

Disease Clauses

The general nature of these clauses is to provide insurance cover for business interruption loss caused by occurrence of a notifiable disease at or within a specified distance of the policyholder's business premises. There were some variations between the wordings of the clauses that were being appealed, though the Supreme Court concluded that these did not make a material difference to their findings.

Using an RSA wording as an example, the court considered what was meant by "*any … occurrence of a Notifiable Disease within a radius of 25 miles of the Premises*". "*Notifiable Disease*" was 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*."

Insurers argued that this only covered cases that occurred within the 25-mile radius and any cases outside this area were not part of the insured peril. Therefore, the Insured must be able to show that the losses were caused by a case that occurred within the 25-mile radius. This would severely limit the cover available as it would be extremely difficult (if not impossible) for policyholders to be pinpoint the location of the exact cause of the loss such that they could prove that it is within the 25-mile radius. The FCA argued that the clause should be read as covering the business interruption wherever the case occurred, provided there was at least one case within the radius. This had been accepted by the High Court.

The Supreme Court reached its own interpretation. It did not consider there was any ambiguity in the wording and that no reasonable reader would understand that the clause would include any case occurring outside the radius. Although this was a more narrow interpretation than that of the High Court, its effect was counteracted by the findings on causation (discussed below), with the result that the circumstances of the pandemic were still found to be covered by the disease clauses.

Prevention of Access and Hybrid Clauses

A prevention of access clause provides cover for interruption to a business where there has been an order by a public authority that prevents the use of the insured premises. Hybrid clauses are where one element is the occurrence of a notifiable disease combined with other elements which narrow

its scope. Such clauses contain a series of elements that must all be satisfied to trigger the indemnity. The decisions in relation to the disease element of the clauses were the same as set out above. In relation to the other elements, the court found the following.

Force of Law - The Supreme Court considered whether the lower court was correct in its findings that the restrictions imposed by the public authority must carry the force of law. The significance of this point being that some losses would have been incurred by general restrictions that were imposed prior to the Regulations issued on 21 and 26 March 2020.

The Court agreed that "restrictions imposed" by a public authority would be understood as ordinarily meaning mandatory measures. It did not, however, accept that a restriction must always have the force of law before it can fall within this description. They did not go as far as saying which, if any, of the government announcements would amount to 'restrictions imposed' and noted that this point was for further argument. Hence, important issues of whether the various government advisory statements constituted "restrictions imposed", remains unresolved.

Inability to use – The High Court had found that the inability to use meant a complete inability to use the premises. Although the Supreme Court agreed with insurers that an inability to use must be established, they did not accept that it must be an inability to use all parts of the premises for any business purpose. They concluded that the requirement was satisfied either if the policyholder is unable to use the premises for a discrete part of its business activities or if it is unable to use a discrete part of its premises for its business activities. In both cases there would be an inability to use. The court gave an example of a golf course allowed to remain open but with its clubhouse closed.

Prevention of access – the Court held that prevention means stopping something from happening or making an intended act impossible and is different from mere hindrance. However, on the same analysis as above, the wording may include the prevention of access to a discrete part of the premises or to the whole or part of the premises for the purpose of carrying on a discrete part of the business.

Interruption – Insurers argued that this should mean a stop or break and was different from 'interference'. This was rejected by the Court, which said that the ordinary meaning of "interruption" was quite capable of encompassing interference or disruption, which did not bring about a complete cessation of the business or its activities.

Causation

The Court spent considerable time considering the issue of causation and its applicability to the construction of the policy wordings. Their analysis of the test for causation and how that may be applied in circumstances where there is more than one proximate cause of loss, or where clauses require that more than one condition must be satisfied to trigger the indemnity, is worth reading in full.

One of the main issues before the Court was the application of the 'but for' test. The Supreme Court agreed with the findings of the lower court that, in the context of the imposition of the national

measures, the situation should be analysed on the basis that all cases were equal cases and acted in combination in bringing about a loss. Insurers disagreed with this approach on the basis that it could not be said that 'but for' any of the individual cases, the government would not have imposed the measures. Insurers argued that the 'but for' test was essential and must be satisfied before the insured peril can be regarded as a proximate cause. Using that analysis, insurers argued that, due to the nature of the pandemic and its widespread impact, the losses would have been suffered anyway, even if the particular insured peril had not occurred, due to the other cases that occurred elsewhere in the country.

The Court rejected this argument. Although it agreed that the 'but for' test would apply in the vast majority of insurance cases, the test was not without its weaknesses and could lead to unsatisfactory results. The Supreme Court noted that the Covid-19 pandemic is unique as every case of the disease is a separate occurrence and insured peril. Applying the standard 'but for' test would mean that no cover would be available as it could not be said that any single occurrence gave rise to the insured loss. They concluded that this would not provide a common-sense result and highlighted one of the weaknesses of the test.

The Court referred to a line of insurance cases involving defence costs where it was accepted that policyholders were entitled to an indemnity even though the 'but for' test had not been satisfied.

Impact on disease clauses

The Court placed significant weight on the fact that notifiable diseases can spread widely and rapidly and are unlikely to be contained by a delineated 25-mile radius. It was therefore unreasonable to conclude that, where there has been an outbreak resulting in loss, all the cases would occur within the specified geographical scope. It therefore could not have been the intention of the parties to create a situation in which, where there are uninsured losses outside the radius, this should in any way limit or restrict the indemnity provided for losses that are covered under the policy. The Court concluded that if this was the intention, such losses could have been expressly excluded.

Trends Clauses

All of the sample wordings contained Trends Clauses. These clauses are intended to determine the relevant counterfactual scenario to put the insured in the position it would have been in had the insured peril not occurred. Insurers argued that the trends clauses meant that they were not liable to indemnify policyholders for losses that would have arisen as a result of the wider consequences of the pandemic.

The Court considered that the purpose of these clauses was to provide adjustments to be made to reflect a more accurate figure and, in line with the indemnity principle, ensure that the figure payable is representative of the true loss. Such adjustments can work in favour of either the insured or the policyholder but it is intended to be in the interests of both.

In considering these issues, the Court noted the following:

- Trends clauses are part of the machinery for quantifying loss. They do not address the scope of the indemnity, which is the function of the insuring clauses.

- Trends clauses should, where possible, be construed consistently with the insuring clauses.

- This means that they should not take away cover provided by the insuring clauses as to do so would be to transform the machinery into an exclusion.

The Court concluded that the most straightforward way to interpret these clauses was to recognise that the purpose of the clause was to arrive at the result that would have been achieved but for the insured peril and the surrounding circumstances arising out of the same originating cause. As such, the trends clauses should be construed to mean trends or circumstances which are wholly unrelated to the insured peril. This was consistent with market practice and the way that such clauses had been interpreted historically.

Pre-Trigger losses

This issue was significant in relation to business which may have suffered a loss as a result of an insured peril but before the policy was triggered. Disagreeing with the lower court, and consistent with its findings in relation to causation and trends clauses, the Supreme Court concluded that any indemnity should not be reduced to reflect any downturn in turnover which was a result of the insured peril and which would have continued even if cover had not been triggered. Accordingly, the loss is calculated by reference to what would have been earned had there been no pandemic.

Orient Express

Perhaps the most significant decision of the Supreme Court was its overturning of the 2010 Orient Express Hotels case. By way of brief recap, the claim involved the business interruption losses of a hotel following hurricane Katrina. The hotel was insured under an all risks policy and there was no dispute as to the physical damage to the hotel. In relation to its business interruption losses, it was successfully argued that the devastation to the surrounding area meant that the hotel would have suffered losses even if there was no physical damage to the hotel itself. Insurers relied on this in their argument that, even if the government had not ordered businesses to close, the widespread nature of the pandemic itself would have led to a general downturn in business.

Following the same reasoning as it had throughout the case, the Supreme Court held that the facts meant that there were two concurrent events, each of which could have caused the loss. Using the analysis set out above, they concluded that, where these events arise out of the same circumstances, providing that one of them is not excluded, the loss from both should be covered. The Supreme Court concluded that the Orient Express had been wrongly decided and should be overturned.

Reinsurance Implications

Both cedants and reinsurers are going to have to consider the extent to which their reinsurances cover the original losses.

Aggregation provisions take many forms in reinsurance contracts, but generally the unifying factor for aggregating losses is defined by reference to "events" or "occurrences", "originating cause" or "common cause", or (in the case of CAT XOL in particular), "catastrophes". The Supreme Court considered application of the words "event" and "occurrence". Although this was in the context of the primary wordings (reinsurance not being in issue before the court), the Court referred to the unities test, derived from well-known reinsurance cases:

> *"The word "occurrence", on the other hand, like its synonym "event" has a widely recognised meaning in insurance law which accords with its ordinary meaning as "something which happens at a particular time, at a particular place, in a particular way": See AXA Reinsurance (UK) plc v Field [1996] 1WLR 1026, 1035 (Lord Mustill); Kuwait Airways Corp v Kuwait Insurance Company SAK [1996] 1 Lloyd's Rep 664, 683-686 (and the discussion in that case of the Dawsons Field Award); Mann v Lexington Insurance Company [2001] 1 Lloyd's Rep 1 (CA)."*

Applying this, the majority in the Supreme Court observed:

> *"A disease that spreads is not something that occurs at a particular time and place and in a particular way: it occurs at a multiplicity of different times and places and may occur in different ways involving differing symptoms of greater or less severity. Nor for that matter could an "outbreak" of disease be regarded as one occurrence, unless the individual cases of disease described as an "outbreak" have a sufficient degree of unity in relation to time, locality and cause. If several members of a household were all infected with COVID-19 when a carrier of the disease visited their home on a particular day, that might arguably be described as one occurrence. But the same could not be said of the contraction of the disease by different individuals on different days in different towns and from different sources. Still less could it be said that all the cases of COVID-19 in England (or in the United Kingdom or throughout the world) which had arisen by any given date in March 2020 constituted one occurrence. On any reasonable or realistic view, those cases comprised thousands of separate occurrences of COVID-19."*

These observations appear to indicate that, it is at best problematic for Coronavirus or Covid-19 to constitute a unifying factor under an event or occurrence based aggregation clause. Issues may well therefore arise as to what circumstances actually do fit within the confines of an "event" or "occurrence".

On the other hand, aggregation clauses based on "common cause" or "originating cause", or similar wording, enable a search for a unifying factor that is "altogether less constricted" (*AXA Re v Field*) and may include a state of affairs (and at first instance, Lord Justice Flaux on several occasions referred to Covid-19 as being a "*state of affairs*").

As to what constitutes a "catastrophe", which is often the unifying factor under CAT XOL wordings, there has been no real judicial guidance. The Supreme Court decision does not change that.

Other reinsurance issues that may arise from Covid-19 claims include the application of hours clauses and allocation to contract years (a likelihood that has increased now that the pandemic has straddled more than one calendar year, and in circumstances where an applicable exclusion clause may have been inserted in the renewed reinsurance). The decision of the Supreme Court clarifying original coverage may have reduced the likelihood of "follow the settlements" disputes, particularly under qualified follow clauses. As specific scenarios play out, areas of dispute will become clearer.

CPB Comment

It must be remembered that the FCA Test case did not deal with the position where, as in most property insurances, BI cover is triggered only where there has been physical damage to property. In those cases, the news is better for insurers. In a judgment on 15 October 2020, the Commercial Court granted summary judgment to insurers against a café owner insured under a standard form business interruption policy, written on an "all risks" basis (*TKC London Ltd v Allianz Insurance plc [2020] EWHC 2710 (Comm)*). The Court held that the enforced closure and loss of use of the café did not constitute an insured "loss of property".

Having said that, the implications of the FCA Test Case decision will still be both immediate and far-reaching. As mentioned above, it is anticipated that it could relate to some 700 types of policies across over 60 different insurers, potentially affecting 370,000 policyholders. It will be positive news for many of those policyholders that the Supreme Court has potentially improved their position from the High Court decision. In addition, the overturning of the Orient Express Hotels case will have even wider consequences, going well beyond application to pandemics and resulting in increased quantum in claims arising from natural (and possibly other) disasters generally.

All this will have a knock on effect to the insurance market generally. The losses are likely to be substantial. Premiums will increase, capacity may reduce and businesses may find it more difficult to obtain cover. The implications of Covid generally are already being felt in areas such as broker's PI cover. Although brokers may feel some relief following the Supreme Court's decision, in circumstances where policyholders find that they are not covered as they expected, they will still be looking to recover those losses from elsewhere. It is anticipated that D&O policies will also be impacted.

The Supreme Court's wide interpretation of the "inability to use"/"prevention of access" clauses in situations where businesses are still able to use part of their business/premises, will have a significant impact on how claims are adjusted. It will require careful analysis of which parts of the business were able to continue as well as calculating how new (and possibly more lucrative) elements of the business impact the indemnifiable losses.

Both policyholders and insurers will be checking their wordings carefully to consider how they are affected by the findings of the Supreme Court. Although at a high level the judgment suggests that cover will be available under most policies containing the insuring clauses considered, each will come down to the specific facts of the claim and the precise wording of the policies. Claims that have already been made will need to be reviewed and insurers can expect to receive a flood of new notifications. In reinsurance, cedants and reinsurers will need to consider the extent to which losses can be recovered under reinsurance contracts, a subject on which they may disagree.

Looking to the future, in an article published on 15 January 2021 (the same day as the Supreme Court judgment) entitled "Why pandemic risk is uninsurable", Denis Kessler, Chairman and CEO of SCOR, concluded:

"…only the government can cover the cost of the economic impact of such a major crisis, through redistribution mechanisms that spread the cost over all economic agents, and even over several generations. It's not surprising then that to date no country has managed to develop a system whereby insurance covers this cost. It's not about bad faith on the part of insurers, rather it's a question of technical and economic impossibility."

It remains to be seen whether government and the insurance industry can together come up with a solution to the problem (to which end the PandemicRe steering group, chaired by Stephen Catlin, was established last April).

Carter Perry Bailey has significant experience in reviewing business interruption insurance wordings. We are able to advise on the implications of the Supreme Court decision, as well as offer advice on policy wording for both insurance providers and policyholders that are considering changes to their standard cover. We are also experienced in advising on reinsurance coverage issues and the drafting of reinsurance contracts.

Samantha Zaozirny
Associate

T: 0203 697 1906
M: 07780 221676
E: samantha.zaozirny@cpblaw.com

Stephen Carter
Partner

T: 0203 697 1902
M: 07887 645262
E: stephen.carter@cpblaw.com