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Landmark Insurance Judgment from the UK Supreme Court

Determination of the FCA Business Interruption Insurance Test Case Appeal

On 15 January 2021 the Supreme Court handed down its judgment in the highly anticipated FCA Test Case appeal, which finally determines the FCA's test case regarding insurers' obligation to pay out on business interruption claims made by policyholders as a result of the COVID-19 pandemic.

As previously noted by BSF, this decision was anticipated to be the most significant insurance decision of the decade, and the judgment has delivered on that, developing the law in this area in ways which are likely to have repercussions across the insurance universe.

By way of recap, the FCA had commenced 'test case' litigation to establish whether policies of eight insurers covered business interruption arising from the COVID-19 pandemic, and the scope of that coverage given the particular circumstances of the pandemic and the UK government's response to it. The first instance judgment was largely favor of the FCA on the majority of policies. Appeals lodged by both the FCA and insurers were – due to the urgency and importance of the decision – leapfrogged to the Supreme Court.

In short, the Supreme Court came down strongly in favor of the policyholders, reaching findings that broaden the scope of the coverage of the business interruption insurance policies that were the subject of the litigation. Insurers should now have much more limited scope to reject or limit policyholders' claims, although some issues do remain undecided, such as impact of government grants, aggregation, and quantum. Further, the spotlight may now turn to insurers' protections through the reinsurance market, and over types of insurance coverage (property damage, loss of rent) which were outside of the scope of the FCA test case.

The Issues Before the Supreme Court

The Supreme Court was asked to determine a number of questions regarding the construction of the relevant clauses, in particular:

- The interpretation of "disease clauses" which cover business interruption caused by an outbreak of disease within a specified distance of the premises;
- The interpretation of "prevention of access clauses" which cover business interruption caused by the denial of access to premises following public authority action and "hybrid clauses" which contain both disease and prevention of access elements; and

- The interpretation of "trends clauses" which prescribe a standard method of quantifying business interruption losses by comparing the performance of a business to the counterfactual – or an earlier period of trading – to make the adjustment.

In addition, the Supreme Court was asked to determine whether the High Court was correct:

- In relation to its analysis of the question of causation; and
- In its analysis of the *Orient-Express Hotels* case (in which it was held that losses that would have been suffered in any event as a result of a competing uninsured cause were not recoverable under a property damage policy).

The Supreme Court's Judgment

The Supreme Court largely allowed the appeals of the FCA and the policyholders (although, on some key points, reaching the same conclusions but for different reasons) and dismissed the insurers' appeals. In particular:

1. **Disease Clauses:** The Supreme Court rejected the High Court's position that as a matter of construction, both local and non-local outbreaks were relevant considerations, holding that coverage is limited to business interruption losses resulting from an individual occurrence in specified geographical radius of the insured premises. Instead, the Supreme Court found that there needed to be at least one COVID-19 case within the specified radius. However, because of findings on causation (see below) the Supreme Court ultimately reached a similar conclusion to the High Court regarding the scope of cover.

2. **Prevention of Access and Hybrid Clauses:** The Supreme Court found that any instruction given by a public authority would satisfy the requirement of a "restriction imposed" so long as it is mandatory and/or carries the imminent threat of legal compulsion, rejecting the High Court's interpretation that the measure must carry the force of law. The Supreme Court considered certain of the government messages mandating people to "stay at home" (ahead of the relevant legislation being passed) and found those to be sufficient, although it did not consider each and every communication/message. In addition, the Supreme Court found that that "prevention of access" or "inability to use" may be satisfied where a policyholder is unable to use the premises for a discrete business activity, or is unable to use a discrete part of the premises for its activities – for example, a restaurant would be able to claim for losses even if it was able to remain partially open for takeaway.

3. **Causation:** The Supreme Court reached important findings on causation, rejecting insurers' arguments that the "but for" test was determinative of causation (i.e. that because of the widespread nature of the pandemic, the same interruption to business would have occurred even if COVID-19 was not within the specified radius, and so the loss would not have been suffered but for that local illness). Instead, the Supreme Court found that it was sufficient that the relevant peril was one of a

combination of other events which brought about the loss, even if the peril itself would not have on its own have caused that loss. The Supreme Court reached this finding on the basis of the purpose and wording of the policy. For disease clauses, the Supreme Court found that it was sufficient for a policyholder to show that loss was proximately caused by at least one case of COVID-19 within the geographical area covered by the clause. In relation to "prevention of access" and "hybrid" clauses, the Supreme Court found that it was sufficient for the loss to result from a chain of insured events as long as those events were ultimately connected with the same underlying cause (the COVID-19 pandemic) covered by the clause.

4. **Trends clauses:** The Supreme Court also made important findings with respect to trends clauses, finding that they were relevant for quantification of loss and not construing the scope of the policy (and so could not be used by the insurers to limit this scope by the backdoor). This meant that the Supreme Court found that trends clauses should be construed consistently with the insuring clauses and, if possible, not in a way to limit coverage (i.e. as an exception). Here, this meant that trends clauses should only be engaged by circumstances that were unconnected with COVID-19, and not to deal with circumstances with the same underlying cause. The Supreme Court also rejected the High Court's finding that pre-trigger losses (i.e. the downturn experienced by a business in the lead up to the imposition of restrictions) should be factored into an adjustment and instead found that the policies should cover losses calculated by reference to the counterfactual that there was no COVID-19.

5. **Orient Express:** The Supreme Court held that the *Orient Express* (which the insurers had relied on as part of their appeal) was incorrectly decided and should be overruled (going further than the High Court, which had found only that they did not need to consider it, albeit suggesting that they would not have followed had they had to). The *Orient Express* case found that losses claimed under insurance for one insured peril (hurricane damage to a hotel) were not recoverable where those losses would have occurred but for the insured peril (i.e. the hotel would have lost revenue even if it had survived the hurricane intact, because of the devastation caused to the surrounding area (which was not within the scope of the insurance). Consistent with its findings on causation and trends clauses, the Supreme Court found that the case had been wrongly decided and overruled it – the Supreme Court found that the appropriate approach would have been to have decided that the losses arose from the same underlying event (the hurricane) and that was sufficient.

The Impact of the Judgment

This decision carries significant importance for business interruption insurance policyholders and insurers, as well as those adjacent to those parties in this space: reinsurers, holders of other insurance forms, and office-holders and creditors of companies with potential claims under insurance policies.

In the immediate term, and pending further FCA guidance on issues such as quantifying losses, the judgment puts policyholders in a strong position as they seek recoveries from insurers under business

interruption insurance. Following this clear judgment from the Supreme Court, the avenues for dispute by insurers are now much more limited, particularly in key areas such as multiple proximate causes of loss (insured/uninsured), partial closures, closures or losses for reasons other than as mandated by law, and the impact of trends clauses on quantification of losses.

However, the Supreme Court judgment (and the FCA test case) does not cover all areas, and there are likely to be further disputes: quantification of losses more generally (outside of trends clauses); aggregation and the impact of sub-limits; and the interplay between government grants and insured losses. There will be question marks as to how far insurers push these areas of disputes, given the success of the FCA to date in fighting the corner for policy-holders.

The battle may now turn to other areas. Whilst insurers have moved back and forward as to their stated ability to meet the losses which will now be imposed on them, their current position appears to be that they are able to do so – although this may change as reinsurance disputes play out and the UK government's support package evolved. Relatedly, we now expect the focus to shift towards disputes between insurers and reinsurers, particularly around aggregation language in reinsurance policies, and any mismatch between the scope of the insurance to policyholders and the insurers' protections by way of reinsurance. Finally, we will wait to see how this judgment practically impacts on other areas of insurance such as property damage and loss of rent, both in the short term for businesses without business interruption insurance, and in the longer-term as disputes unrelated to COVID-19 arise. Indeed, the Supreme Court's findings on causation and trends clauses, and its overruling of *Orient Express Hotels*, would seem to give rise to further testing of the law in this area in circumstances where there are multiple or competing causes of loss.

Outside of the UK, we also expect the Supreme Court's judgment to have a ripple effect. Whilst non-binding, it will be read with interest by Courts across Europe and in common law jurisdictions who are hearing similar disputes.

We are available to discuss any queries on the Supreme Court judgment, business interruption insurance coverage relating to COVID-19, or disputes arising in this insurance and reinsurance space more generally.

CONTACT

Tracey Dovaston
Partner, London
+44 203 908 0726
tdovaston@bsfllp.com

Fiona Huntriss
Partner, London
+44 203 908 0723
fhuntriss@bsfllp.com