CORONAVIRUS: LANDMARK JUDGMENT IN BUSINESS INTERRUPTION INSURANCE TEST CASE

The English High Court has given a landmark judgment setting out how business interruption (BI) insurance will respond to claims brought by policyholders who have suffered loss due to the COVID-19 pandemic. The judgment is good news for most insureds, and correspondingly less so for many insurers.

BACKGROUND

BI insurance protects policyholders against the risk of financial losses and related expenses incurred as a result of disrupted operations arising from physical damage and also, in some instances, non-physical damage, e.g. the impact of a notifiable disease or a prevention of access.

However, when COVID-19 began to spread across the UK, there was a disagreement between certain insurers and insureds as to whether their non-damage BI wordings actually provided cover for effects of the pandemic. The Financial Conduct Authority (FCA) determined that, pursuant to its role as a regulator, it would seek to reduce uncertainty in the market and protect consumers by bringing proceedings to obtain court declarations in respect of coverage and causation issues under such policies, as part of a test case under the new Financial Markets Test Case Scheme. The test case was heard in July and judgment was handed down on 15 September 2020.

During the hearing, Lord Justice Flaux and Mr Justice Butcher heard arguments from the FCA (representing the interests of policyholders) and insurers in respect of how clauses in 21 lead policies should be interpreted. These sample wordings are considered representative of some 700 varieties of policy underwritten by over 60 different insurers, potentially affecting around 370,000 policyholders.

SUMMARY OF JUDGMENT

Overall, the judgment is good news for most policyholders – BI cover is available under most of the policies considered.

Key regulatory issues

- Judgment represents a victory for policyholders in main areas of contention
- Where insurers accept liability, the FCA will be keen to see insurers handle and assess non-damage BI claims promptly and treat their customers fairly, in line with Principle 6 of the FCA Handbook
- Whilst the test case does not determine the quantification of any BI claims payments, the FCA has issued a statement on considerations that should be taken into account when applying deductions of government support received by policyholders
- In the longer term, and following the publication of finalised guidance, the FCA is expected to maintain an interest in product value, and insurers and insurance intermediaries should therefore consider how the value of their products may change following the judgment. For further commentary on product value and mis-selling, please refer to our earlier briefing linked here

Three categories of clause were considered:

1. **Disease** clauses, where cover is triggered by the occurrence of a notifiable disease within a defined area;
2. **Prevention of access** clauses, which cover prevention of use/access because of government/relevant authority action; and
3. **Hybrid** clauses, which are a blend of the first two types.

Approach to construction

At the core of the judgment was an approach which focused on construing the relevant insuring clause in each policy to determine what conditions needed to be satisfied in order to trigger cover and what causal link they needed to have to each other or to the loss.

The judges rejected arguments from the insurers that it was necessary to consider questions of causation separately by holding that upon proper construction of the wordings, the nature of the exact peril that was intended to be insured can be established. Once that insured peril is correctly identified, it is possible to distinguish non-insured causes and therefore largely bypass separate issues relating to causation.

Following careful analysis of the precise wording in individual policies, the insured peril, across all of the wordings that were said to offer cover in principle, was held by the judges to be a composite peril made up of indivisible elements. For instance:

- **Disease** – (i) interruption or interference to an insured's business as a result of (ii) a specified provision (e.g. a *'notifiable disease occurring within the vicinity of an insured location*')
- **Prevention of access** – (i) prevention or hindrance of access to or use of premises as a result of (ii) an action of a governmental authority owing to (iii) a specified provision (e.g. '*an emergency likely to endanger life or property*')
- **Hybrid** – (i) inability to use premises as a result of (ii) an action of a governmental authority following (iii) a specified provision (e.g. '*the occurrence of a notifiable disease*')

Value of loss

When assessing the value of loss sustained by an insured, many policies required a comparison between actual revenue, and that which would have been generated had the insured peril not occurred – the 'counterfactual'.

The Court held that in determining the counterfactual, every element in an insured peril should be stripped out of the counterfactual situation. Thus construed, application of these composite perils would not enable insurers to use trends clauses to reduce the value of cover extended to insureds, as some of them had argued, by seeking to include in the counterfactual a scenario where COVID-19 was still present and having impacts elsewhere.

By this route the judges did not expressly overrule *Orient-Express Hotels Limited -v- Assicurazioni Generali S.p.A.* – a case which held that a hotel in New Orleans impacted by Hurricanes Katrina and Rita could only claim under its BI policy the difference between its actual profits and those it would have

made had the hotel been left untouched while the hurricanes devastated the rest of the city – but made clear that they considered it was wrongly decided.

IMPACT ON POLICYHOLDERS

Disease in the 'vicinity'

In general, the ruling on disease wordings is particularly favourable for policyholders, in that for most clauses which require the presence of the disease in the 'vicinity' of the insureds' premises, the Court held that an insured is only required to demonstrate the presence of the disease in the vicinity, not that such presence had any causal link to its losses, which in most instances will likely have been caused by national responses to the pandemic rather than any particular case of the disease.

Many insureds will now still need to prove that there was an occurrence of COVID-19 in the vicinity of their insured premises. What this means varies from policy-to-policy – for those requiring simply the presence of the disease, establishing one undiagnosed asymptomatic case is enough, but that would not suffice if a policy states that the disease has to have 'manifested'.

The judges accepted in principle that it would be possible to prove the presence of the disease on the balance of probabilities by reference to government data and by means of a statistical analysis of whether that meant the disease was likely present in the vicinity, but reached no factual conclusions on this point as the parties agreed not to adduce expert evidence at the hearing. It remains to be seen whether insurers will put insureds to proof on this point; the FCA was concerned that this might represent a significant burden for smaller insureds.

Prevention of access – 'enforced closure'

Where prevention of access clauses contain 'enforced closure' language, a key finding was that the enclosures need to be 'enforced' in the sense that they need to be the result of legally binding governmental authority action.

This may give rise to some difficulties, due to the UK government's delay both in announcing lockdown and in issuing binding rules to enforce it – many businesses shut down when the government first issued non-binding advice, or indeed sooner when the risks of continuing operations were becoming apparent.

On 17 March 2020, the UK government announced that, following a meeting with representatives of the insurance industry, insurers had agreed that the government's initial advice to close would be treated as sufficient to trigger insurance policies which required government action. Hiscox, RSA, and Zurich were the only defendants in attendance at that meeting. The judges did not grapple with the legal effect of that announcement – and policyholders may have arguments, particularly if their insurers were represented at the 17 March meeting – but as it stands the judgment provides that policyholders whose policies require an 'enforced' closure (as opposed to mere advice) to be triggered do not have cover for losses arising in the period prior to binding regulations being issued.

IMPACT ON INSURERS

Policies not affording cover

There were some victors among the insurers: it was ruled that all of the policies under consideration from Ecclesiastical and Zurich do not provide cover for BI in relation to the pandemic. Coverage under Hiscox's policies is confined to insureds who were mandated to shut by a government, under certain circumstances, and then only if they hold the correct policy, i.e. fewer than one-third of its 34,000 UK BI policies. The court also agreed with QBE's interpretation of two out of three of its disease wordings.

Appealing the judgment

It remains to be seen whether there will be an appeal, but one is expected. In line with the Framework Agreement entered into by the parties at the outset of the proceedings, any appeal must be conducted expeditiously. It is possible that the appeal will leapfrog the Court of Appeal and be heard directly by the Supreme Court, with a final decision out by the end of the year or early 2021. However, a party seeking a leapfrog appeal may have some difficulties in demonstrating that the test for an appeal to the Supreme Court – that an appeal raises an arguable point of law of general public importance – is satisfied. Whilst the impact of the judgment is no doubt highly significant, the judgment itself treated the issues as primarily ones of contractual construction rather than points of law.

For now, all parties await the consequentials hearing which is due to be held on 2 October 2020 – there, any applications to appeal and for expedition of leapfrogging will be heard.

Payments to policyholders

In the meantime, the FCA has stated that it expects insurers to contact all affected policyholders within seven days to update them on next steps and to progress claims, in particular where the claims would not be affected by any appeal. Under English law, a judgment is binding on parties to it notwithstanding that an appeal is pending (unless a party obtains a stay) and various representatives of insureds have indicated that they plan to seek immediate interim payments from insurers.

The Dear CEO letter issued by the FCA on 18 September 2020 suggested that it (as a regulator) did not expect insurers to pay out immediately if issues relevant to a claim were subject to an appeal. However, from a legal perspective, should insurers refuse to pay out valid claims within a reasonable time such that policyholders suffer additional losses as a result of late payment, those insureds may seek to claim damages from the insurers under the Enterprise Act 2016.

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