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THE WIDER IMPLICATIONS OF THE FCA TEST CASE

While the High Court's judgment is highly significant, it treats the issues as primarily ones of contractual construction rather than points of law.

Baljit Rai (Senior Associate) and Kengyi Kwek (Associate)

When Covid-19 began to spread across the UK, there was uncertainty as to whether non-damage business interruption insurance wordings actually provided cover for the effects of the pandemic. The Financial Conduct Authority (FCA) thus sought 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 September 15.

During the High Court hearing, Lord Justice Flaux and 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 policy wordings are considered representative of some 700 varieties of policy underwritten by more than 60 different insurers, potentially affecting around 370,000 policyholders.

Overall, the judgment is good news for most policyholders; business interruption cover is available under most of the policies considered.

Three categories of clause were considered:

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

Approach to construction

At the core of the judgment was an approach that focused on construing the relevant insuring clause in each policy to determine what conditions needed to be satisfied 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 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 (for example, 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 (for example, "an emergency likely to endanger life or property"); and

Hybrid: i) inability to use premises as a result of ii) an action of a governmental authority following iii) a specified provision (for example, "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 what would have been generated had the insured peril not occurred – the "counterfactual".

The court held 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 an impact elsewhere.

By this route the judges did not expressly overrule *Orient-Express Hotels v Assicurazioni Generali* but made clear they considered it was wrongly decided.

Policyholder impact

The ruling on disease wordings that require the presence of the disease in the "vicinity" of the insureds' premises is particularly favourable for policyholders. For most of these clauses, the court held 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. As losses will in most instances likely have been caused by national responses to the pandemic rather than any particular case of the disease, a contrary finding could have posed a significant obstacle for insureds.

Many insureds will now still need to prove 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 says the disease has to have "manifested".

The judges accepted in principle 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 this might represent a significant burden for smaller insureds.

Enforced closure

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

This may give rise to some difficulties as a result of 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 March 17 the UK government announced following a meeting with representatives of the insurance industry, insurers had agreed the government's initial advice to close would be treated as sufficient to trigger insurance policies that 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 March 17 meeting – but as it stands the judgment provides 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 before the binding regulations were issued.

Insurer victors

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

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 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 the test for an appeal to the Supreme Court – that an appeal raises an arguable point of law of general public importance – is satisfied.

While 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 October 2, 2020 – there, any applications to appeal and for expedition of leapfrogging will be heard.

In the meantime, the FCA has said 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 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 September 18 suggested 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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CONTACTS

Baljit Rai
Senior Associate
London
T: + 44 207006 8714
E: baljit.rai
@cliffordchance.com

Kengyi Kwek
Lawyer
London
T: + 44 207006 1633
E: kengyi.kwek
@cliffordchance.com

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