CORONAVIRUS: SUPREME COURT JUDGMENT IN BUSINESS INTERRUPTION INSURANCE TEST CASE: REAL ESTATE IMPACT

The English Supreme Court has substantially allowed the appeal by the Financial Conduct Authority (FCA) on behalf of policyholders and dismissed the insurers' appeals in the business interruption (BI) insurance test case brought by the FCA. The result is more BI policies will respond to claims by policyholders who have suffered loss due to the COVID-19 pandemic and the losses recoverable under responding policies may in some cases be greater. We consider what this means for landlords and tenants and future lease negotiations.

WHAT IS BI INSURANCE?

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, in some instances, non-physical damage, e.g. the impact of a notifiable disease or prevention of access to the place of business. Many businesses have BI cover in place, but it is most common in the hospitality and leisure sector. BI policies are different to the building insurance and "loss of rent" policies typically taken out by landlords at the tenants' cost.

BACKGROUND TO THE TEST CASE

As a result of the COVID-19 pandemic, business owners have suffered major BI and many turned to their BI policies to cover the losses suffered. Insurers disputed that the BI policies provided cover and in response, proceedings were brought by the FCA – acting on behalf of policyholders – to obtain court declarations as to whether 21 sample English-law governed BI policies issued by eight insurers provided cover in principle for BI losses arising from the pandemic. These samples are considered representative of some 700 varieties of policy underwritten by over 60 different insurers, potentially affecting around 370,000 policyholders.

The English High Court ruled in September 2020 that cover was available under most (but not all) of the policy wordings considered, albeit with certain limitations. This decision was appealed and permission was granted for the appeal to 'leapfrog' the Court of Appeal and be heard directly by the Supreme Court. The Supreme Court substantially allowed the appeals of the FCA on certain grounds upon which they did not succeed at first instance, whilst

Key takeaways

- Supreme Court has substantially allowed the appeals of the FCA, whilst unanimously dismissing the insurers' appeals
- More BI policies will respond to claims by policyholders who have suffered loss due to the COVID-19 pandemic and the losses recoverable under responding policies may in some cases be greater
- Insurers put many claims on hold pending the decision. Insurers expected to progress those pending claims, as delay could give rise to claims from policyholders for damages under the Enterprise Act 2016
- The question of coverage is fact-sensitive. Policyholders will still have to grapple with complexities in assessing the extent of cover available.
- For more information on the case and ruling, please see this briefing by our insurance colleagues.
- For full commentary on the first instance judgment, please refer to our insurance colleagues' earlier briefing linked here

unanimously dismissing the insurers' appeals. The effect is to expand the number of policies which will now respond and, in some cases, increase the amount of loss which may be covered.

SUMMARY OF THE DECISION

The key elements of the Supreme Court's decision on the cover offered by BI policies with non-damage clauses in relation BI losses arising from the pandemic ("**pandemic cover**") is set out below. For details of the clause types see the box opposite.

- **Meaning of 'interruption'** – There does not need to be a complete cessation of the policyholder's business or activities. It is enough for there to be interference or disruption if it impacts the financial performance of the business.
- **Disease clauses** – The Supreme Court came to the same conclusion as the High Court on this type of clause but for different reasons. In principle, clauses of this nature provide cover for business interruption caused by at least one case of illness resulting from COVID-19 occurring within the specified radius of the premises set in the policy. The fact that there were also cases outside this radius which caused interruption to the business does not affect the cover provided.

  A causal link between the relevant cases within the specified radius and the interruption to the business will need to be shown. However, where the interruption stems from lockdown restrictions, a sufficient causal link is showing that at least one case occurred in the relevant radius before those restrictions were introduced.
- **Prevention of access/hybrid clauses** – The Supreme Court widened the potential cover offered by these types of clause in two ways:
  - Where a mandatory restriction is required, Government guidance can in principle be mandatory if it carries the imminent threat of legal compulsion or its terms and context clearly indicate that compliance is required without recourse to legal powers. In essence, the Prime Minister's broadcasts where he instructed the public to "stay at home" should now be considered a policy trigger. This is in line with the Government's previous announcement that following a meeting with a small number of insurers, the entire insurance industry had agreed that those instructions would be treated as binding restrictions for the purposes of BI policies. A timeline of announcements and regulations is provided in the box on the next page.
  - Whilst clauses triggered by an inability to use (or access) the premises do require a complete inability to use (or access) not simply such use being hindered, a partial closure would be sufficient. This could be either (i) a policyholder's inability to use a discrete part of premises and/or (ii) its inability to use the premises for a discrete part of its business activities. This will mean policies could now respond for restaurants which were restricted to offering takeaway in respect of losses suffered by the 'dine-in' part of the business. The High Court had initially ruled that restaurants would only be able to recover losses if, prior to the restrictions, they only operated an 'dine-in' business and so the whole of their pre-pandemic activities had been prevented.

Relevant Non-Damage Clauses

- **Disease Clauses:** Losses resulting from an interruption caused by the occurrence of a notifiable disease on the premises/within x miles of the premises
- **Prevention of Access Clauses**: Prevention or hinderance of use of/access to the premises due to intervention by a government or local authority.
- **Hybrid Clauses**: Prevention or hinderance of use/access due to intervention by a government or local authority in response to the occurrence of a notifiable disease.

- **Losses** – Payments should not be reduced on the basis that the loss would have resulted in any event from the COVID-19 pandemic or that the loss was also caused by other uninsured effects of the pandemic.

For more information on the case and ruling, please see the briefing from our insurance colleagues.

IMPACT ON LANDLORDS, TENANTS AND LEASES

Will all tenants with a BI policy have pandemic cover?

No, not all tenants with BI cover will have a relevant non-damage clause providing cover for diseases or prevention of use/access. This cover is usually optional and must be purchased for an additional premium. The FCA estimated in Spring 2020 that most BI policies will only have basic BI cover and not extend to cover losses arising from the pandemic. The test case only concerns the interpretation of policies which have relevant non-damage clauses which purport to provide pandemic cover.

A tenant has pandemic cover, does the Supreme Court ruling mean that it will be able to recover its losses?

To the extent that tenants do have relevant non-damage clause(s) providing pandemic cover, in principle many (but not all) tenants will be able to recover some or all of their losses. However, careful analysis of the policy wording in each individual case will be required. For example:

- For disease clauses requiring an occurrence of COVID-19 within a specified radius, the relevant distance and whether an occurrence of a COVID-19 case can be proved will need to be assessed. The FCA is currently consulting on draft guidance for policyholders on how to prove the presence of coronavirus (a requirement under some policies). Final guidance is expected following closure of the consultation on 22 January 2021.
- If a tenant's business was not required to close completely (e.g. restaurants ordered to close to 'dine-in' customers but permitted to continue offering takeaway), the question of whether a defined part of their business/premises was completely prevented will need to be considered.
- Not all businesses have been required to close – professional services firms such as accountants and lawyers as well as construction and manufacturing businesses have never been subject to mandatory closures and may not be able to demonstrate the requisite inability to use their premises required by prevention of use or hybrid clauses.
- Some insurers are factoring government support received by policyholders into calculation of claim payments. The FCA issued a statement in August 2020 encouraging insurers to treat claims individually on the basis of the terms of the policy, the claim and how the policyholder applied any government support they received.

There will, despite the favourable nature of the Supreme Court's judgement, remain some policies which will not respond. By way of indication, Hiscox estimate that fewer than one third of its 34,000 BI policies will respond to the pandemic.

Key Dates First National Lockdown

- **31 January 2020**: First two positive Covid cases in England
- **5 March 2020**: COVID-19 classified as a notifiable disease in England
- **11 March 2020**: WHO declares pandemic
- **16 March 2020**: PM instruction to avoid pubs, clubs, theatres and other such social venues and UK Government advice on social distancing issued
- **18 March 2020**: PM statement that schools to close from end of 20 March and reiteration of 'stay at home' instruction
- **20 March 2020**: PM statement that cafes, pubs, bars and restaurants should close as soon as they reasonably could and not open the following day
- **21 March 2020**: UK regulations requiring closure of restaurants, cafes, bars and pubs (except takeaway). Other business closures included cinemas, theatres, nightclubs, spas, gyms and leisure centres.
- **23 March 2020**: PM 'stay at home' statement and non-essential shops to immediately close
- **24 March 2020**: UK Government guidance issued requiring holiday accommodation providers to close for commercial use
- **26 March 2020**: UK regulations replacing and extending 21 March regulations. Further businesses required to close including non-essential retail, personal care services and holiday accommodation.
- **4 July 2020**: 26 March regulations revoked and replaced with more limited restrictions marking the beginning of the end of the first national lockdown.

Will tenants with responding policies be able to recover all losses since March 2020?

It will be challenging for tenants to recover all losses in full. For example, many BI policies have a time limit on non-damage clauses (typically three months) even if the actual interruption continued beyond that time. Similarly, most BI policies will have financial limits on the indemnity purchased. In addition, the question of when cover begins will depend on the type non-damage clause, the exact wording of that clause, the nature of the business and both how and when the business was impacted by the pandemic.

What impact will the ruling have on rent concessions which have been agreed by landlords and tenants?

This will depend on whether there is a legally binding agreement between the landlord and the tenant documenting the concession. If there is no binding agreement, it is possible landlords will seek to reconsider informal rent deferrals or reductions if tenants will be able to recover their losses under BI policies.

If there is a binding agreement, the parties will be bound by it unless they agree to legally vary the terms. Depending on the wording in the policy, binding agreements which provide for rent reductions may be factored into the calculation of tenants' losses under their BI claims and reduce the BI insurance proceeds.

Where the binding agreement provides for a rent deferral with a requirement to pay interest on the deferred rent, there may be an advantage to tenants using BI insurance proceeds to prepay the deferred rent to reduce those interest charges.

What impact will the ruling have on current rent concession negotiations?

Landlords who are currently negotiating rent concession with tenants are likely to require tenants to provide details of their BI insurance position. The probability of a tenant being able to successfully claim under a BI policy (and the amount and anticipated timing of any such payments) will affect the tenant's financial position and therefore the commercial negotiations.

If uncertainty remains because the exact terms of the BI policy still need to be assessed, landlords may seek to structure agreements so that they don't affect the amount a tenant can claim under its BI policy coupled with claw-back provisions (in the case of rent reductions) or early payment provisions (in the case of rent deferrals) triggered if a tenant succeeds with its BI claim.

Will the decision affect the terms of future leases?

Since the outbreak of the pandemic, tenants have been seeking 'pandemic' clauses providing a full or partial rent suspension in the event of a future pandemic. Landlords have largely been resisting such clauses. These negotiations will no doubt be affected by the test case. The greater certainty around the ability of tenants to be able to successfully mitigate such risks via BI policies will alter the risk profile and therefore, the negotiating positions going forward.

How will the availability of pandemic cover in future BI policies be affected by the judgment?

Even before the judgment, most insurers were putting express exclusions for COVID-19 and/or pandemics more generally in new BI policies and the judgment will not have changed this. As a result it is now more difficult to obtain BI policies offering pandemic cover and any cover available is very expensive. However, the impact of the pandemic on businesses means there demand for such policies will remain. There have been calls for pandemic cover to be provided in a similar way to terrorism cover under the state backed Pool Re insurance – a so called "Insurance Re". Landlords and tenants will watch these developments with interest.

Will tenants be able to recover losses arising from closures during the second and third national lockdowns and local lockdown measures?

The test case was heard in July 2020 and as a result only considered the first national lockdown. However, the principles set out by the courts apply to the interpretation of BI policies generally and so could be equally applied to later restrictions. Whether, cover is in fact available for subsequent restrictions will depend on the wording of policy, the nature of the business and how it was impacted by subsequent restrictions.

As most BI policies have a time limit on non-damage clauses (typically three months), policyholders may need to demonstrate separate insured events occurred in order to cover losses arising from later closures.

Will tenants be able to recover losses arising from enforced restrictions on trading hours?

This will depend on the terms of the relevant BI policy and will be more challenging for a claim under a prevention of use or hybrid clause which requires a complete inability to use the premises.

WHAT HAPPENS NEXT?

The judgment brings clarity for many critical coverage questions relating to BI insurance, and no further appeals are possible. Insurers will no doubt be mindful of their exposure to claims for damages for late payment under the Enterprise Act 2016 when processing claims, and the FCA's Dear CEO letter of 22 January 2021 makes it clear that it now expects insurers to proceed with making payments.

However, it must be stressed that the question of coverage is fundamentally one that is fact-sensitive. Policyholders will likely still have to grapple with complexities in assessing the extent of cover available. The FCA has stated that it will publish resources to assist policyholders with claims on its dedicated BI insurance webpage.

For advice on the implications of the Supreme Court's judgment on the test case, please contact your usual Clifford Chance contact or any of the individuals listed in this briefing.

CONTACTS

Lindsay Mann
Senior Associate
Knowledge Lawyer

T +44 20 7006 2021
E lindsay.mann
@cliffordchance.com

Sarah Thomas
Counsel

T +44 20 7006 4307
E sarah.thomas
@cliffordchance.com