The Supreme Court COVID-19 business interruption insurance decision in a nutshell

On 15 January 2021, the Supreme Court handed down its judgment in *The Financial Conduct Authority & Ors v Arch Insurance (UK) Ltd & Ors* [2021] UKSC 1. It considered whether non-damage business interruption policies responded to losses caused by the COVID-19 pandemic.

The case was heard as a leapfrog appeal from a decision of Flaux LJ and Butcher J in September 2020. It was the first test case under the Financial Markets Test Case Scheme. It is estimated that the decision could affect policies held by some 370,000 policyholders.

This article summarises the decision. It is a companion piece to a longer analytical article about business interruption insurance and COVID-19 generally which may also be found on our Chambers website.

The Supreme Court unanimously dismissed the insurers' appeals and allowed all four of the FCA's appeals (in two cases on a qualified basis). The practical effect is that all of the insuring clauses which were in issue on the appeal will provide cover for the business interruption losses caused by COVID-19.

In summary:

- The majority of the court (Lords Hamblen, Leggatt, and Reed) held that the insured peril in "disease" clauses was business interruption losses caused only by cases within the specified area.

- But, since the majority went on to hold that all individual cases were equally causative of the national measures which actually interrupted the businesses, the narrow interpretation of the insured peril did not prevent the policies from providing cover.

- The prevention of access and hybrid clauses could be triggered by mandatory instructions by public authorities – and not just by legislation. Importantly, the effects of the "underlying or

originating cause" of the insured peril (namely, the pandemic) would be ignored when addressing causation under these clauses.

- In respect of quantum, "trends" clauses would not take into account matters inextricably linked to the pandemic. Similarly, pre-trigger downturns in revenue attributable to the pandemic would also generally be ignored.

Disease Clauses

These clauses provided cover for business interruption loss following occurrences or manifestations of a notifiable disease at or within a specified distance of the policyholder's business premises.

The Supreme Court held:

- The disease had to occur within the specified area in order to trigger these clauses.

- An "occurrence" of the disease meant that someone had contracted the disease as a matter of fact, even if they were asymptomatic or undiagnosed (but the position was different for policies referring to a "manifestation" of the disease).

- The insured peril was the business interruption losses caused by the cases of disease within the specified area. This was based on the true construction of the policy wordings.

- The High Court had been wrong to hold that the disease clauses covered business interruption consequences of the disease wherever it occurred, provided it also occurred at least once within the specified area. This had involved a rewriting of the policies.

Prevention of Access and Hybrid Clauses

These are, respectively:

- Where access to premises is prevented due to restrictions imposed or government advice; and

- Business interruption because of closure of or restrictions on the premises as a result of a notifiable human disease occurring or manifesting itself at the premises or within a prescribed distance of the premises.

The Supreme Court held:

- The disease element of the "hybrid" clauses had to be interpreted in the same way as in the "disease" clauses. The disease therefore had to "occur" or "manifest" in the specified area, depending on the particular policy wording.

- The High Court was wrong to decide that "restrictions imposed" on the premises had to have the force of law. There would be "restrictions imposed" as long as the restriction was in mandatory and clear terms and it would reasonably be understood from the context that compliance was required.

- The "restriction imposed" did not have to be directed at the particular business affected. The prohibition on people leaving their homes could in theory be a "restriction imposed" in relation to businesses allowed to stay open after lockdown.

- Some policies imposed an additional requirement that the "restrictions imposed" resulted in an "inability to use" or a "prevention of access to" the premises. An impairment or hindrance to use or access would not be enough to trigger these clauses. So, the prohibition on people leaving their homes would probably not qualify.

- However, in order to trigger such clauses, the inability or prevention only had to relate to discrete business activities carried on at the premises or to discrete physical parts of the business premises.

- For example, a bookshop required to close its premises to walk-in customers would be "unable" to use the premises for the discrete business activity of selling books to walk-in customers, even if it could keep using the premises for telephone orders.

Causation

On the basis of the Supreme Court's narrow interpretation of the disease clauses, the issue of causation assumed central importance.

The Supreme Court held:

- The policies used a variety of wordings to set out the required causal connection between the insured peril and the loss to be indemnified. Not much turned on the differences in wordings because the issue of causation was ultimately a legal rather than a "linguistic" one.

- The national public health measures were taken in response to information about all the cases of COVID-19 in the country. All of the individual cases of COVID-19 which had occurred by the date of any Government measure were equally effective "proximate" causes of the measure (and of the public response to it). The usual "but-for" test was displaced on proper construction of the policies.

- For the disease clauses to apply, it was therefore sufficient for a policyholder to show that at the time of any relevant Government measure there had been at least one case of COVID-19 within the geographical area covered by the clause.

- A difficulty in relation to the prevention of access and hybrid clauses was that they specified a number of causal links which had to be satisfied before the policy would respond. The Supreme Court held that business interruption losses were covered only if they resulted from all the elements of the risk covered by the clause operating in the required causal sequence.

- However, the fact that such losses were also caused by other (uninsured) effects of the COVID-19 pandemic did not exclude them from cover under such clauses. This was because the pandemic was the "underlying or originating cause" of the insured peril.

Trends Clauses

These clauses are used to value the claim under the policy. Trends clauses do this by adjusting the results for special or unusual circumstances during the trading period prior to the indemnity period, so as to estimate as nearly as possible what results would have been achieved but for the insured peril.

The Supreme Court held that these clauses should not be construed so as to take away cover provided by the insuring clauses (considered above). The trends and circumstances for which the clauses require adjustments to be made do not include circumstances arising out of the same underlying or originating cause as the insured peril. In the present context, this meant effects of the COVID-19 pandemic.

<u>Pre-trigger Losses</u>

The High Court allowed adjustments to be made under the trends clauses to reflect a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered.

For example, if the turnover of a pub in the week ending on 20 March 2020 was only 70% of its turnover in the equivalent week of the previous year (due to circumstances that did not amount to restrictions imposed), then that downturn would have to be accounted for when calculating the loss.

The Supreme Court rejected this approach. Adjustments should only be made to reflect circumstances affecting the business which were unconnected with COVID-19.

<u>The "Orient-Express" Element</u>

The insurers relied on the *Orient-Express* case in support of their arguments on causation. It was a case which concerned damage caused to a hotel by hurricanes.

Hamblen J (as he then was) had essentially accepted that the proper approach under the trends clause in that case was to recognize that, even if it had not been damaged itself, the hotel would still have lost all its business due to the hurricane damage to the surrounding area.

The High Court said that this case could be distinguished. The Supreme Court went further and said that this case was wrongly decided and should be overruled. It was wrong to take into account the impact of the hurricanes: "the correct approach in the *Orient-Express* case would have been to construe the trends clause so as to exclude from the assessment of what would have happened if the damage had not occurred circumstances which had the same underlying or originating cause as the damage".

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