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SUPREME COURT HANDS DOWN ITS JUDGMENT IN THE COVID-19 BUSINESS INTERRUPTION INSURANCE TEST CASE

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SUMMARY

The UK Supreme Court in the Test Case on Business Interruption Insurance brought by the FCA on behalf of policyholders has decided that the FCA's appeal (on behalf of policyholders) should be substantially allowed, with Insurers' arguments widely dismissed.

Jonathan Sacher and Richard Jennings consider what the judgment means for businesses and the (re)insurance market.

Background

In May 2020 the UK's Financial Conduct Authority (FCA) announced that it would be commencing a 'test case' against insurers, amidst widespread disagreement between policyholders and their insurers as to whether losses caused by COVID-19 were covered under existing business interruption insurance policies. Less than 9 months later, the UK's Supreme Court, the country's highest court, has handed down its eagerly anticipated judgment on the matter.

Commercial Court ruling

As has been well publicised, large swathes of businesses have suffered significant losses as a result of COVID-19, and the subsequent Government-mandated lockdowns and restrictions on businesses. Many businesses turned to their business interruption insurers to indemnify them for those losses, only for most claims to be declined.

Given the prevalence of this issue across the market (as well as the wide variety of wordings in existence) the FCA selected a representative sample of 21 policy wordings that it would ask the Court to rule on. Those policy wordings were allocated into 3 categories by the Commercial Court:

(1) Disease clauses – clauses that provide cover for business interruption following the occurrence of a notifiable disease within a specific radius of insured premises.

(2) Hybrid clauses – clauses that provide cover for business interruption following restrictions being imposed on a premises as a result of a notifiable disease occurring within a specific radius of the insured premises.

(3) Prevention of Access clauses – clauses that provide cover for business interruption following the prevention or hindrance of access or use of the premises following government or local authority action.

The Commercial Court handed down its judgment in September 2020. Broadly, the position adopted by the Court was that Disease clauses *did* provide cover (subject to certain exceptions based on specific policy wording), as did Hybrid clauses (albeit cover may be more restricted based on a narrow construction of certain terms related to business closure and use). However, Prevention of Access clauses, on the whole, *did not* provide cover (again, subject to certain exceptions based on particular policy wording).

The FCA, and some insurers, appealed the Commercial Court's judgment directly to the Supreme Court.

What issues were the subject of appeal?

Our previous article set out some of the key issues that were the subject of appeal in more detail, but they can be briefly summarised as follows:

For the FCA, on behalf of policyholders, the focus of the appeal was on the interpretation of particular phrases such as "restrictions imposed" and "inability to use", as well as on issues of quantum such as an insurer's right to take into account a decline in income prior to closure (but still directly or indirectly linked to the pandemic) when calculating what that business' actual loss was over the period, and how much it is required to pay out. The FCA did not appeal the Commercial Court decision on the local effect of Prevention of Access clauses so the appeal dealt primarily with certain aspects dealing with Hybrid clauses, and the associated assessment of losses for claims that were covered (according to the Commercial Court).

For insurers, the points of appeal included (a) challenging the Commercial Court's determination of the relevant insured peril as a "composite" one, (b) challenging issues of causation between individual COVID-19 cases and the national lockdown, and (c) the appropriate 'counterfactual' scenario that an insured's losses should be measured against (i.e. is the loss based on what a business would have earned had there been no pandemic and no lockdown, or based on what a business would have earned had there been no lockdown, but with COVID-19 still gripping the nation).

What has the Supreme Court decided?

The FCA were largely successful in their points of appeal. In its judgment, the Supreme Court held:

1) Disease clauses – the majority of the Supreme Court disagreed with the Commercial Court's ruling and held that only business interruption losses caused by cases of the disease within the specified radius of the premises were covered. However, although this was one issue of principle in which Insurers were successful, ultimately it made no difference to the outcome, given how the Supreme Court ruled on the causation issue (see below).

2) Prevention of Access and Hybrid clauses – agreeing with the FCA, the Supreme Court disagreed with the Commercial Court's interpretation of terms such as "restrictions imposed" and "inability to use". In the case of the former, it was not necessary for measures to have the 'force of law' to amount to a restriction imposed. Instead, measures introduced by a competent authority in mandatory and clear terms, or which carry the imminent threat of compulsion, will be sufficient. As to an "inability to use", the Supreme Court also adopted a wider interpretation than the Commercial Court, holding that this may well be satisfied if a policyholder cannot use its business (or part of its business) for a discrete activity.

3) Causation – because of the Court's ruling on the interpretation of Disease clauses, the issue of causation became of huge significance. The Supreme Court did not accept Insurers' argument that, because lockdowns and losses would have been incurred by policyholders even if there was not a case of COVID-19 within the specified radius, there was not a sufficient connection between the particular occurrence of COVID-19 and the loss (i.e. the Government action was in response to all cases, not just those cases in a particular radius). As a result of the Supreme Court's ruling cover is likely to be available to a policyholder under a Disease clause if it can demonstrate that there had been a single case of COVID-19 within the particular radius prior to the lockdown/restriction being introduced.

Although the 'local effect' of certain Prevention of Access clauses was not at issue in the appeal, we may well see individual policyholders revisiting their policies and seeking to apply the Supreme Court's rationale to those clauses, and establishing cover where there seemed no prospect of obtaining any after the Commercial Court's ruling. This is something to keep an eye on in the coming weeks and months.

4) Trends clauses – the Supreme Court held that trends clauses (i.e. clauses allowing an insurer to adjust a policyholders' loss to take into account prevailing trends and circumstances) cannot be used by Insurers to deprive policyholders of the benefits of cover, if those trends and circumstances arise from the same insured risk. In other words, the policyholder's loss cannot be reduced by arguing that there would have been no business in any event because of the pandemic.

5) Pre-trigger downturns in business – many policyholders had started to see a reduction in business because of the pandemic, prior to any lockdown or other restrictions being imposed on

them. Consistent with their approach to the trends clauses, the Supreme Court held that these 'pre-trigger' trends could not be used to reduce a policyholder's insured loss.

6) The *Orient Express* case – in its judgment in September 2020, the Commercial Court held that, although it was not applicable to the circumstances in front of them, the *Orient Express Hotels v Assicurazioni Generali* case was wrongly decided. The Supreme Court has looked again at the Orient Express case and agreed with the Commercial Court that it had been wrongly decided and should be overruled. Similar to the detailed analysis of the law of causation the Court undertook, where an insured risk and an uninsured risk operate together, as long as the damage caused by the uninsured peril was not excluded under the policy, any loss resulting from both causes operating concurrently is covered. This aspect of the judgment is likely to have significant ramifications in the calculation of losses in business interruption cases following natural disasters and other instances of physical damage, and the market needs to review its BI wording to address this.

What does this mean?

Although we expect many businesses to submit claims to their insurers following the Supreme Court's judgment (including some businesses who have previously had their claims declined following the Commercial Court's judgment) we do not anticipate many cases being issued in the country's County and High Courts. Though the judgment is complex and detailed, the principles established as far as coverage for COVID-19 BI losses are concerned, are clear. It is not beyond the realms of possibility though that we see some peripheral issues being litigated, for example whether a particular limit of indemnity is 'per premises' or 'per insured'. One can see how much of a difference this would make for a business operating tens or hundreds of sites across the UK.

Now that UK law is largely settled in this area, insurers' attention will now turn to adjusting, valuing and paying valid claims, as well as calculating their overall losses for the purpose of making recoveries from their reinsurers. We expect to see numerous reinsurance presentations throughout 2021, and given the size of the numbers involved (which will have increased materially following the Supreme Court's judgment), it is possible that we see some significant reinsurance disputes being arbitrated or litigated.

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