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Business Interruption Insurance – A UK Update

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For many UK businesses with business interruption ("**BI**") insurance policies, a high priority this autumn was keeping up with a rapidly changing regime of coronavirus-related restrictions – changes which last week culminated in the imposition of the second England-wide 'lockdown'. As such, the 15 September judgment of the High Court in the FCA's BI insurance test case potentially takes on even greater significance, given the number of businesses that have been required to close their doors once again. In this article, part of our series on insurance-related issues, we consider the outlook for BI policyholders and insurers, and look at what the insurance community has learned about coronavirus and BI insurance.

The High Court test case

In a previous article, we reported on the FCA's actions to intervene in the BI insurance stand-off by bringing a court action designed to clarify BI coverage questions for thousands of policyholders. On behalf of policyholders, the FCA put forward arguments in an expedited "test case" in respect of 21 different classes of policy from 8 different insurers, arguing that those policies do respond to certain business losses caused by coronavirus restrictions. The FCA's action was partly in response to the prospect of multiple fragmented legal actions, threatened by groups such as the 'Hiscox Action Group', with the aim of proving that the losses sustained by their members were covered.

At the outset, one precedent, in particular, appeared to present an obstacle to the FCA's case, namely, the case of *Orient-Express Hotels Ltd v Assicurazioni Generalis SA [2010] EWHC 1186 (Comm).* In that case, it was held that the insured, whose hotel in New Orleans had suffered physical damage as a result of Hurricanes Katrina and Rita, could not recover for BI losses. This was because it was held that the insured's business would have suffered significant losses, regardless of the physical damage to the hotel specifically, as a result of potential customers not travelling to New Orleans in the aftermath of those hurricanes (i.e., that the physical damage to the hotel *did not itself* cause the losses). Prior to the FCA's test case, the insurance community had debated whether the same reasoning could apply, in this case, to prevent coverage applying to thousands of policyholders across the country.

The 15 September judgment

Judgment in the test case was handed down by the High Court on 15 September. Twelve of the policies were held to provide coverage – at least to some extent - over losses resulting from coronavirus restrictions. The types of clause at issue were divided into three kinds:

1. Prevention of access clauses ("**POA Clauses**"). These clauses provide coverage where there has been a prevention or (more rarely) a hindrance of access to or use of the premises, as a consequence of government or local authority action or restriction. For instance, the Arch policies, considered in the test case, provide that: "*[w]e will also indemnify You in respect of reduction in Turnover and increase in cost of working as insured under this Section resulting from… (7) Prevention of access to The Premises due to the actions or advice of a government or local authority due to an emergency which is likely to endanger life or property.*"

2. Disease Clauses. These clauses broadly provide coverage in respect of BI losses in consequence of, or following, or arising from, the occurrence of a notifiable disease within a specified radius of the insured premises. In the test case, the policies in the category termed 'RSA 3' provide that: "*[w]e shall indemnify You in respect of interruption or interference with the Business during the Indemnity Period following: (a) any… iii. Occurrence of a Notifiable Disease within a radius of 25 miles of the Premises*".

3. Hybrid Clauses. These clauses refer to both restrictions imposed on the premises, and the occurrence or manifestation of a notifiable disease. In the test case, the policies in the category termed 'Hiscox 1' provide that: "*[w]e will insure you for your financial losses and other items specified in the schedule, resulting solely and directly from an interruption to your activities caused by… 13. Your inability to use the insured premises due to restrictions imposed by a public authority during the period of insurance following… b. an occurrence of any human infectious or human contagious disease, an outbreak of which must be notified to the local authority*".

The judgment found that many of the POA Clauses in the policies would not respond to BI losses caused by the coronavirus restrictions. This was partly because the term "*prevention*" had to be interpreted restrictively, namely, to mean more than a mere hindrance. So, for instance, a restaurant that ordinarily offered both takeaway food and eat-in service would not have suffered a "*prevention*" of access under the coronavirus restrictions. Similarly, non-binding government advice could not "*prevent*" use of the premises, as "*prevention*" was held to require legal (or physical) impossibility. Additionally, many of the clauses were worded restrictively so as to cover "*emergency*" or "*danger*" in the immediate "*vicinity*", which the Court held referred to the specific neighbourhood of the business and not the country more generally. This and other factors meant that policyholders would be required to overcome a substantial factual burden before cover would be provided under the policies.

In respect of Disease Clauses, the Court held that most of the policies considered which contain such clauses would provide coverage (with the exception of some of the QBE policies). The insurers argued in such cases that the policyholder would need to demonstrate that BI losses were the result of the occurrence of the disease within that area specifically. However, it was observed that the nature of many notifiable diseases is that they can spread over a wide area, and could therefore have an effect at a large distance from a particular case, including through the reaction of the authorities. The Court held that the parties must therefore be taken to have agreed that the cover extended to BI losses arising from a notifiable disease, of which there was an occurrence within the relevant policy area. The judgment noted that "*much of [the insurers'] argument was put in terms of causation*". This argument, according to the judgment, was answered by the proper construction of the clauses (which implied that two related outbreaks should be considered part of one indivisible cause, and could not be regarded as independent causes).

The position in respect of Hybrid Clauses was generally positive for policyholders, although only in respect of certain types of business. As with POA Clauses, the judgment held that "*restrictions imposed*" (or similar wording) meant something with the force of law, so that the advice given by the government not to attend restaurants or bars was not sufficient to provide coverage. The term "*inability to use*" was also interpreted restrictively, leading to the conclusion that most businesses did not suffer an "*inability to use*" their premises due to the restrictions on people leaving their homes without a reasonable excuse. However, the Court did not accept that an "*occurrence*" implied something small-scale and local, and held that the outbreak of COVID-19 in the UK could qualify as an "*occurrence*" of a notifiable disease.

The judgment also contained a discussion of so-called 'trends clauses', which prescribe that the level of coverage provided will be moderated in accordance with separate trends and causes affecting the business, outside the insured peril. Many of the insurers argued that these clauses would imply that coverage was restricted to the level of turnover, which the business would have achieved absent the local disease outbreak, but in the context of the wider national outbreak. However, given that the Court found each local outbreak to be one part of a larger indivisible cause (the national outbreak), the Court held that the relative counterfactual for assessing a 'trends clause' was a scenario where the national outbreak never happened at all (and not purely one which stripped out the local outbreak only). Therefore, a 'trends clause' could not be used to limit coverage under the policies in the way that the insurers argued.

Finally, on causation, although the Court held that most issues had been answered by its construction of the specific policy wordings, it also roundly rejected the reasoning in *Orient-Express Hotels*. It held that the judge in the case misidentified the insured peril as "*the damage*", when in fact the insured peril was "*[d]amage caused by a covered fortuity, here the hurricanes*" – i.e., the hurricanes were in fact "*an integral*" part of the insured peril. This implied that when analysing the counterfactual in the case, the judge should have stripped out not just the physical damage to the hotel caused by the hurricanes, but also the hurricanes and their effect generally, such that the whole effect of the hurricanes was covered. The effect of *Orient-Express Hotels* was that the worse the fortuity befalling the insured and the vicinity of the insured's premises, the less the insurance responds – an effect which this judgment held "*cannot have been intended.*"

Reactions to the judgment

In a press release issued on the day of the judgment, the Interim Chief Executive of the FCA commented: "*[w]e are pleased that the Court has substantially found in favour of the arguments we presented on the majority of the key issues.*" The FCA also encouraged insurers to move ahead with paying out on claims, despite any pending appeals to the judgment, and applauded the new certainty for insured businesses brought by the judgment.

The reaction from other market participants varied. A statement from the Association of British Insurers said (in contrast to the FCA's view) that: "*[t]he judgment divides evenly between insurers and policyholders on the main issues*". It added that insurers "*regret any contract dispute with their customers and will continue to reflect on feedback from recent events.*" A statement from the Night Time Industries Association said that the organisation was "*thrilled with the positive result for 370,000 policyholders and the difference it will make to the survival of their businesses.*"

Partly due to the publicity generated around the Hiscox Action Group, Hiscox has been one of the more high-profile defendants in this case. As we noted in our previous article, Hiscox stated earlier in the year that its core small commercial package policies "*do not provide cover for business interruption as a result of the general measures taken by the UK government in response to a pandemic.*" A statement from Hiscox on 15 September, following the judgment in this case, said that the judgment clarified that fewer than one third of Hiscox's UK BI policies would be responsive, and that Hiscox now estimated additional COVID-19 claims arising from BI losses to amount to less than £100 million net of reinsurance. The same statement ends with an effort to reassure investors that "*trading conditions continue to improve in every segment*", and "*Hiscox's capital position remains strong*".

Similarly, although RSA noted that the FCA judgment had caused it to increase claims reserves by £62 million net of reinsurance, it also issued a generally positive trading update on 5 November. Some of the negative impacts of the judgment, RSA said, were offset by a general decrease in non-COVID-19 claims frequency, mostly reflecting lower economic activity.

Appeal to the Supreme Court

Following the judgment being handed down, eight parties requested permission to appeal the judgment: the FCA, six of the defendant insurers, and the intervening Hiscox Action Group. The parties agreed that appeals would 'leapfrog' the Court of Appeal, and be heard directly by the Supreme Court. All those who had applied for permission to appeal were granted it on 2 November, and the appeal will be heard by the Supreme Court from Monday 16 November for an expected four days. Details of the appeal can be found on the FCA's website.

The FCA's application for permission to appeal makes the important observation that the appeals in the case will be the first time the Supreme Court (or House of Lords) has addressed BI insurance. The FCA will appeal the judgment on four grounds:

1. Quantum. The FCA will dispute the Court's indications that businesses may not be able to recover losses in circumstances where COVID-19 (and the response to it) would have depressed a policyholder's revenue anyway, even without public authority action triggering the cover, if COVID-19 happens to have already had such an effect prior to the triggering of the policy. The FCA will argue that these indications are inconsistent with the Court's other findings on the insured peril, with the normal workings of BI insurance, and with the Court's findings on *Orient-Express Hotels*.

2. Mandatory/force of law. The FCA will argue that the Court made an error of law in finding that only the imposition of legally binding prohibitions would satisfy such triggers in the policies as public authority "*action*", "*enforced closure*", or restrictions being "*imposed*". Rather, it will argue, the clauses as properly constructed would respond to explicit public authority instructions to close (as were issued on 16 March and other occasions in March), and instructions to customers to stay away. If compliance was expected (as in the case of the government's March statements), the FCA will say that it would be commercially absurd for policies not to respond to provide coverage in respect of BI losses.

3. Total closure. The FCA will argue that the Court was wrong to find that prevention of access and hybrid wordings were only triggered by complete closure of the business for the purposes of carrying on the business, or almost total inability to use the premises. It will say that this interpretation is inconsistent with the purpose of BI policies, including their use by businesses operating multiple activities, and their purpose of compensating disruption or interference with business (rather than total "*catastrophe*").

4. Incident/event and the nature of disease clause cover. The FCA will argue that the Court made an error of law in finding that usage of the terms "*incident*" or "*event*" in the policy types QBE 2 and QBE 3 implied that the policies responded uniquely to local-only outbreaks. The finding of the Court was in contrast to its finding in respect of other disease clauses, which was that they were intended to respond to the disease (as a whole), providing that it came near the premises. The FCA will argue that the diseases covered by these clauses by their nature spread in

complicated and unpredictable ways, and the QBE 2 and QBE 3 clauses therefore envisage (as the other disease clauses do) that there might be public authority action affecting a wide area.

As to the insurers' cases, the FCA considers that one of the fundamental points it expects to be defending in appeals by insurers is the Court's finding that, even for POA Clauses, the occurrence of the disease is an essential element of the insured peril, and therefore must be stripped out in any counterfactual employed to assess losses. This point will indeed be central, alongside numerous other grounds (for example, Hiscox is granted permission to appeal in respect of eight separate grounds). Those other grounds will likely include a close focus on the policies' 'trends clauses', and on the reasoning of the Court in rejecting the findings on causation of *Orient-Express Hotels*.

Concluding thoughts

For now, the judgment has reshaped some of the pressures on the insurance industry arising from the pandemic. However, the existence and scale of the appeal proceedings in the case temporarily limit the significance of the 15 September judgment.

To the extent that some parties have been (or will be at appeal) absolved of liability—such as Zurich, whose policies were held not to provide cover and will not be the subject of any appeal—the focus may shift to other potentially liable parties, such as insurance brokers who may have misrepresented and/or mis-sold policies. Equally, to the extent that insurers are held liable for losses due to COVID-19 in this case, and more widely, the relevant judgments may renew calls for a government-backed reinsurance scheme to act as a safety net for an industry under strain. As in respect of terrorism and flooding, it may be decided that pandemic-related risk is a systemic risk which the insurance industry is unable to or should not be expected to carry without government support. In short, much will turn on the decisions in these appeals, and policyholders should watch their progress carefully.

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