CORONAVIRUS: SUPREME COURT JUDGMENT IN LANDMARK BUSINESS INTERRUPTION INSURANCE TEST CASE

On 15 January 2021, the Supreme Court handed down its judgment in the appeal of the landmark test case brought by the Financial Conduct Authority (FCA) about business interruption (BI) insurance coverage for insureds who have suffered loss as a result of the COVID-19 pandemic. The overall result represents a repeat – and indeed slight improvement – of the broad success policyholders won at first instance. However, the different approach in the Supreme Court's reasoning will have wider implications for the market beyond the scope of BI insurance.

BACKGROUND

At the start of the COVID-19 pandemic, business owners suffered major BI as a result of public authority responses to the spread of the disease and a significant number of disputes between such owners and their insurers subsequently arose. In response to this, proceedings were brought by the FCA – acting on behalf of policyholders in its capacity as a regulatory body – to obtain court declarations as to whether 21 sample English-law governed BI policies provided cover in principle for BI losses arising from the pandemic, and if so, on what conditions. 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 by insurers and the FCA (along with the intervening Hiscox Action Group, who represented certain policyholders). In light of the potential impact of the issues at stake, permission was granted for the appeal to 'leapfrog' the Court of Appeal and be heard directly by the Supreme Court over the course of a four-day hearing in November 2020.

In broad terms, policyholders have repeated their victory as the Supreme Court has substantially allowed the appeals of the FCA and interveners on certain grounds upon which they did not succeed at first instance, whilst unanimously dismissing the insurers' appeals. The net result is that all of the insuring clauses in issue on appeal have been held to provide cover for BI caused by the COVID-19 pandemic, and trends clauses will not operate to

Key takeaways

- This is an unprecedented judgment for a unique case that was admitted under the Financial Markets Test Case Pilot Scheme for the very first (and possibly only) time
- The result represents a broad success for policyholders, with the Court determining that there was coverage in principle across the wordings under consideration, rejecting arguments by insurers which would have reduced the scope of coverage, and determining on certain points that cover was more expansive than the High Court had
- Insurers put many claims on hold pending the decision. Insurers should now work to progress those claims, as delay could give rise to claims from policyholders for damages under the Enterprise Act 2016
- There is likely still to be a number of issues for determination on particular claims, in particular concerning the precise quantification and aggregation of losses
- For full commentary on the first instance judgment, please refer to our earlier briefing linked here

significantly reduce the indemnity available in the manner contended for by insurers.

Notwithstanding the similar overall result, the judges' reasoning diverges significantly from that of those in the court below, and will likely be of relevance to many insurance claims under all categories of policies. Most notably, the majority adopted a narrower interpretation of the relevant policy triggers than the High Court, but nevertheless found cover by application of causation principles. The judgment contains a detailed analysis of how causation principles apply to policy clauses which contain multiple triggers and where there are multiple causes of loss; the relevance of this decision is therefore not confined to those making and evaluating claims under BI insurance.

SUMMARY OF THE DECISION

The appeal focused on three categories of insuring clauses which are common across most relevant BI policies:

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

It also analysed **trends clauses**, which operate as part of the machinery for quantifying loss under the insurance.

Disease clauses

Under BI insurance, cover is provided for the consequences of an insured peril, which means the way in which a peril is defined is critical. Across all of the wordings that were held to provide cover at first instance, the High Court had defined the insured peril as a composite one made up of indivisible elements, all of which must be satisfied before an insurer's obligation to indemnify is triggered, but not all of which needed to have caused the relevant loss.

A number of disease clauses providing cover for losses arising from (i) the effects of a notifiable disease by reference to (ii) its incidence within a specified radius (most commonly in this case, 25 miles) were considered. The High Court held that only (i), the effects of a disease as a whole were needed to cause a loss, and the occurrence of a disease within the radius was simply something which needed to have happened as a condition for cover. Thus, whilst there needed to have been a case of COVID-19 occurring within the radius of the insured premises to trigger a policy, BI losses caused by COVID-19 as a disease per se, i.e. occurring anywhere in the world, were covered provided that there had in fact been an occurrence of the disease in the relevant radius.

The Supreme Court rejected this approach, and held that disease clauses only provide cover for BI consequences of individual cases of illness resulting from COVID-19 that occur within the stipulated radius. As the description of the insured peril is materially similar across all disease clauses, the Supreme Court extended this interpretation to all disease clauses under consideration, whereas before, it had only been held to apply to the clauses in certain wordings (referred to as QBE 2 and 3).

On this basis, the Supreme Court has adopted a narrower approach to construction of the disease clauses across all wordings by limiting the scope of cover to the effects of specific, localised cases of COVID-19 that occur within the confines of a radius. The word 'occurrence' is a frequent feature in the clauses considered, and the Court reiterated its accepted meaning in insurance law as "*something which happens at a particular time, at a particular place, in a particular way.*" An 'outbreak' of COVID-19 cannot, except under very limited circumstances, be regarded as an 'occurrence', much less the disease as a whole.

Causation

The Supreme Court's finding that the clauses under consideration provide cover is therefore based on their approach to causation. The Supreme Court held that the policy wordings do not limit cover to BI consequences solely attributable to the occurrences of COVID-19 within the relevant radius. In other words, while the interruption must be the result of effects caused by an 'occurrence' of illness within the radius, those consequences may rightly be attributed to both occurrences within and outwith the radius, and nothing in the policies excludes such cover.

Concurrent causes

Under orthodox insurance law principles, an insured peril must be the proximate cause of the loss claimed in order for cover to apply. This means a cause must be a real, efficient cause of the loss. Where there is a combination of proximate causes that are more or less equal in effect, there is cover so long as one of those causes is covered by the policy in question and none of the causes is excluded.

In the present case, the relevant causes of BI were determined to be the government responses to the pandemic. The Supreme Court ruled that each case of an individual contracting COVID-19 in the country amounted to an equal cause of these responses. As it rightly observed, nothing in principle precludes the recognition of thousands of equally operative concurrent causes.

Proximate causes

Perhaps the most significant element of the decision is the determination that these causes were proximate even where the 'but for' test was not satisfied: *"in the present case it obviously could not be said that any individual case of illness resulting from COVID-19, on its own, caused the UK Government to introduce restrictions which led directly to business interruption.*" The Supreme Court refused to engage in an exercise (suggested by insurers) that entailed weighing the relative potency of insured and uninsured causes and instead, highlighted the indivisible nature of the loss, i.e. the effect of all cases of COVID-19, via inextricably linked government restrictions, on any insured business. Given that "*the Government measures were taken in response to information about all the cases of COVID-19 in the country as a whole*", the Court held that proximate causation can be established once it is shown that a policyholder suffered BI as a result of government action taken in response to cases of COVID-19, and of those cases, at least one had arisen within the stipulated geographical area.

The causal connection between an insured peril and loss may accordingly be established where concurrent causes of the loss and the insured peril (e.g. a local occurrence of disease) in combination with other similar uninsured perils

(e.g. a wider pandemic) bring about the loss with a sufficient degree of inevitability, notwithstanding that the insured peril was neither necessary or sufficient to cause the loss by itself.

The 'but for' test

Insurers had argued that a central flaw with the Supreme Court's favoured approach lies in the fact that it cannot be said that but for any individual case of COVID-19, the government measures would not have been enacted. However, the Supreme Court held that the 'but for' test is not always determinative in ascertaining proximate causation, as it is a blunt instrument that tends towards being over-inclusive, whilst also being unnecessarily narrow at times. This may arguably be seen as a departure from orthodoxy, in which the 'but for' test is commonly seen as a minimum threshold for causation.

The ruling of the majority confirms that in the insurance context, satisfaction of the 'but for' test is not essential before an event can be regarded as a proximate cause, if the loss in question stems from multiple concurrent causes. In reaching this conclusion the Court overruled *Orient-Express Hotels Ltd v Assicurazioni Generali SpA* [2010] EWHC 1186 (Comm) – there, insurers successfully employed the 'but for' test to cut down a claim for loss which resulted from two concurrent causes (one insured, the other not), by arguing that the loss was not covered as it would have arisen in any event. The Supreme Court, applying its findings on concurrent causation, held that where both causes arose from the same underlying fortuity, in the absence of an exclusion for the damage proximately caused by the uninsured peril, it was wrong to say that the loss was not covered simply because the 'but for' test was not met.

Prevention of access and hybrid clauses

The Court's analysis of disease clauses also underpins its interpretation of hybrid clauses that have a disease element, but where wordings contain other conditions, a different approach should be taken.

The Supreme Court agreed with the court below that the insured peril covered by prevention of access/hybrid clauses is a composite one comprising a series of interconnected elements to be satisfied, such that the fortuity covered by the insurance would be a scenario where all elements are present. However, the Court considered that both the insurers and the High Court offered flawed arguments in respect of how the causal connections between the different elements in such insured perils interact with each other for the purposes of determining whether loss has been proximately caused by said peril. The 'but for' test was again held to be inappropriate for use in this context.

By way of example, the Hiscox clause examined in the judgment provides cover for losses arising from: *(A) an occurrence of a notifiable disease, which causes (B) restrictions imposed by a public authority, which cause (C) an inability to use the insured premises, which causes (D) an interruption to the policyholder's activities that is the sole and direct cause of financial loss*. The Supreme Court held that the insured peril is the risk of all elements occurring in the causal sequence specified in the relevant clause, such that "*[e]ach additional element in the causal chain narrows the consequences for which the policyholder is entitled to an indemnity*." In this way, the insurance is restricted to particular consequences of an adverse event.

But the scope of the indemnity should not be restricted by other consequences of the adverse event. Building on the indivisible loss argument, the Court noted that the elements of an insured peril and their effects on a policyholder's business can be said to be inextricably linked as they all arise from the same original cause, i.e. the COVID-19 pandemic. The Court held that parties to the insurance would have naturally expected that other, uninsured effects arising from that original cause would occur concurrently with the insured peril, and it would not make commercial sense if those potential effects operated to reduce cover.

Trends clauses

Loss is commonly quantified under BI insurance by comparing the past turnover of a business against the actual revenue gained by it during the indemnity period. In order to achieve a figure that is as accurate a representation of the loss as possible, trends clauses provide that cover should reflect the insured's revenue in a comparable period (e.g. the prior year) with adjustments to be made to the amounts to reflect the insured's particular circumstances. The insurers had argued that the COVID-19 pandemic was one such circumstance and therefore the calculation of an insured's losses should be adjusted to take account of the reduced turnover it would have suffered in any event because of the pandemic.

Such an argument risked drastically reducing cover available, and was roundly rejected by the Supreme Court. The Court emphasised that these clauses have no impact on the scope of indemnity, and should be construed consistently with the insuring clauses in a way that does not reduce the cover available under the latter. The Court held that these clauses do require the application of the 'but for' test: their aim is to arrive at the results that would have been achieved but for the insured peril and related circumstances arising out of the same underlying or originating cause. However, the overruling of *Orient Express* means that, in practical terms, when calculating loss insurers cannot argue that an insured's losses should be reduced because, but for the insured event, revenue would have been reduced by other (uninsured) perils, provided the insured and uninsured perils arise from the same underlying fortuity.

The correct approach to loss quantification in this context thus comprises the following steps:

- Determine the insured peril;
- Identify which activities of the insured business were interrupted by said insured peril;
- Ascertain the income actually earned from those activities during the period of interruption, as well as standard turnover; and
- When adjusting figures to account for trends, disregard any circumstances that are connected to the COVID-19 pandemic.

KEY FINDINGS

Applying the above principles, the Supreme Court made a number of determinations which will be relevant to particular BI claims:

- **Public authority intervention** – where public authority intervention is a policy trigger, such intervention does not, contrary to the High Court ruling, need to have the force of law. If a particular instruction was expressed in

mandatory terms and in a sufficiently clear context such that it enabled a reasonable person to understand what compliance entailed, and that said compliance was required without the need for legal powers, it may amount to a qualifying 'restriction' or 'action'. In essence, the Prime Minister's broadcasts where he instructed the public to "stay at home" should now be considered a policy trigger, even though they happened before the statutory Regulations of 21 and 26 March 2020 became legally binding. Previously, the government had announced 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. No evidence of such an agreement being made has ever emerged, but this finding puts a policyholder in the position they would be in if such an agreement does exist;

- **'Inability to use'** – this is another policy trigger in some prevention of access/hybrid clauses, and the High Court held that it meant a complete inability – apart from *de minimis* use – to use insured premises. The Supreme Court concurred that what is needed is an 'inability' of use and not merely some 'impairment' or 'hindrance'. However, in ruling that cover is triggered if: i) premises are unable to be used for a discrete part of a policyholder's business activities; or ii) a discrete part of the premises is unable to be used for business activities, the Supreme Court has explained that 'complete inability of use' refers in the first scenario to policyholders being completely unable to carry on a discrete business activity, and in the second, to policyholders being completely unable to use a discrete part of the premises. This will widen cover for many insureds;
- **Pre-trigger losses** – despite their finding that when quantifying loss, the correct counterfactual (i.e. the hypothetical situation that would have arisen had the insured peril not occurred) which insurers should consider is one where COVID-19 does not exist at all, the High Court judges went on to hold that if there had been a measurable downturn in a business's turnover due to COVID-19 prior to a policy being triggered, a trends clause could take that into account and therefore operate to reduce the amount of cover available. The Supreme Court has overruled this; only circumstances which are wholly unrelated to COVID-19 should be reflected when adjusting for trends in the context of calculating an indemnity.

CONCLUSION

The judgment brings clarity for many critical coverage questions relating to BI insurance, and no further appeals are possible in these proceedings. 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 2020 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. While the judgment provides straightforward guidance in respect of certain issues, policyholders and insurers may still have to grapple with complexities relating to heads of cover and the application of retentions and limits, in order to determine the quantum of recoverable loss.

The Supreme Court's decision is a useful addition to judgments from elsewhere in the world, and is sure to be closely examined by courts in other jurisdictions.

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