Richard Hopley / Sam Tacey

# FCA test case: the perils of business interruption insurance and COVID-19

## Introduction

The disruption caused by the COVID-19 epidemic has resulted in an influx of claims under property policies insuring business interruption. These claims are not in respect of "traditional" business interruption losses (involving physical damage to property affecting a business). Instead, the claims are under "non-damage" extensions. This has led to a number of difficult issues regarding cover for such claims. The Financial Conduct Authority (FCA), the UK insurance industry's regulator, brought a test case in the English Commercial Court, representing the interests of a large number of policyholders, with the objective of determining issues of principle applying to claims in England.

The FCA's test case involved eight insurers, two interveners and 21 lead policies and was taken to trial in an extremely short timescale. The decision (handed down on 15 September 2020) is long (over 160 pages) and complex. However, by individually reviewing 21 different wordings, the Court has given significant guidance on how the types of wordings represented by the lead polices should be construed and the scope of the cover they provide.

## The decision

The Court was asked to rule on whether the various "non-damage" extensions in issue (which were not contingent on physical damage) provided cover in principle in the context of the COVID-19 epidemic.

The Court reviewed the policies on the basis that the relevant provisions fell into three categories:

– "Disease clauses" – in broad terms, these provide cover in respect of business interruption in consequence of or following or arising from the occurrence of a notifiable disease within a specified radius of the insured premises.

– "Hybrid clauses" – these refer both to restrictions imposed on the insured premises and to the occurrence or manifestation of a notifiable disease.

– "Denial of Access clauses" – these provide cover where there has been a prevention or hindrance of access to or use of the insured premises as a consequence of government or local authority action or restriction.

On 20 October 2020, the Court published a series of declarations setting out its detailed findings in relation to certain aspects of the individual wordings and addressing a number of issues in respect of which the parties had sought clarification of the judgment. The declarations are addressed to the extent relevant below.

### *Approach to construction*

On its face, the judgment is limited to construing (individually and in detail) each representative wording, but a number of themes and principles emerged as issues common to the wordings were addressed. Most of the issues were resolved by the Court's approach to the construction of the policies and in particular the approach to the identification of the peril against which the extension of cover insured.

In construing the provisions, the Court reviewed what was required (in terms of causation) by the "link" words or phrases (such as "in consequence of", "following", "as a result of" and "arising from") in the policies. Section 55(1) of the Marine Insurance Act 1906 (which applies to all forms of insurance) requires the loss to be "proximately caused by a peril insured against". The Court made clear that the relevant "links" were between elements within the definition of an insured peril (and not between loss and the insured peril) and thus did not require proximate causation; rather, a looser causal connection would generally be sufficient. As described below, once the Court took a broad view of the insured perils, it was established that those perils proximately caused the loss as there were no other possible (uninsured) causes.

The approach taken by the Court is best understood by looking at one representative wording (the RSA 3 policy), which provided cover on the following basis:

*"We 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;"*

The insurers argued that the insured peril was *"the effect of a local occurrence of a Notifiable Disease"* with any loss having to be proximately caused by that peril. This narrow approach to the insured peril formed the basis of the insurers' arguments regarding causation, namely, a "but for" test: that even if a Notifiable Disease had occurred within a 25 mile radius of the insured premises, the losses would have occurred in any event as a result of other, uninsured, perils.

The Court, however, favoured the FCA's approach and held that the insured peril was "composite", comprising, in this instance, an interruption of business following an occurrence of the disease within a 25 mile radius. The word "following", a "link" within the definition of the insured peril, required only a loose causal connection between the interruption and the occurrence of a disease; it did not require proximate causation. On this basis, the cover was not limited to business interruption losses caused by specific instances of the disease within the 25 mile radius, but extended to the business interruption consequences of a disease that had occurred in a general sense and of which there had been at least one instance in the specified area. As the court ex-

**Richard Hopley**
Partner, Cooley (UK) LLP, London
**Sam Tacey**
Special counsel, Cooley (UK) LLP, London

plained *"The wording of the clause, in other words, indicates that the essence of the fortuity covered is the Notifiable Disease, which has come near, rather than specific local occurrences of the disease."*

### *Causation*

Having reached its conclusion on "composite" perils, the Court determined that the insurers' extensive arguments relating to causation effectively fell away. As the Court put it, in respect of RSA 3:

*"If, properly construed, there is cover for the effects of a disease which may occur both within and outside the specified radius, and which may trigger a response of the authorities and the public to the outbreak as a whole, then it would be inconsistent with the nature of the cover to regard the occurrence of the disease outside the radius, or the response of the authorities or the public to that occurrence of the disease, as being alternative, uncovered, causes of the business interruption which could be relied on as supporting an argument that there would have been the same business interruption in the absence of the insured peril."*

The Court added that even if the word "following" did require proximate causation, that requirement would have been satisfied by reference to the national response to the widespread outbreak of COVID-19. It explained that *"In such a case we consider that the right way to analyse the matter is that the proximate cause of the business interruption is the Notifiable Disease of which the individual outbreaks form indivisible parts."*

The Court noted that the insurers had relied heavily on the decision in *Orient Express Hotels Ltd v Assicurazioni Generali SpA* [2010] EWHC 1186 (Comm) to support their arguments on causation. In reaching the conclusion that the causation issue was answered by the proper construction of the insured peril, the Court held that *Orient Express* was of no application and went on to say that even if *Orient Express* had been of relevance, it considered it to have been wrongly decided.

The case involved the effects of Hurricanes Katrina and Rita in New Orleans. The judge held that a "but for" test for causation was appropriate. Applying this test, the business interruption loss should be assessed (under the "trends" clause – see below) on the hypothesis that the hotel was undamaged but that New Orleans was devastated. Having identified that the insured peril was confined to the damage to the hotel (and did not encompass the cause of that damage), the insured could not establish that the losses were caused by that damage and not by the surrounding devastation. In short, even if the hotel had remained undamaged, no one would have stayed there.

In the Court's view, the main error in the reasoning in *Orient Express* was the misidentification of the insured peril: the judge should have found that the hurricanes, as the cause of the relevant damage to the insured hotel, were an integral part of the insured peril. The policy did not insure against damage in the abstract, but damage caused by a covered fortuity, namely the hurricanes.

### *Trends clauses*

Trends clauses are intended to account for factors that would have affected the insured's financial position even if the insured peril had not happened. The insurers argued that the alternative scenario (the "counterfactual") to be used in the comparison should assume that the epidemic had occurred. The effect of this would have been to wipe out most claims.

The Court's approach to the construction of the insured peril largely resolved these issues. The Court said that two points applied to all of the trends clauses: first, they are part of the "quantification machinery" (not part of the delineation of cover) for calculating a business interruption loss on the basis that there is a qualifying insured peril; and second, the object of the quantification machinery is to put the insured in the same position it would have been in if the insured peril had not occurred. Here it was held that in construing the trends clauses, every element of the insured peril had to be stripped out of the counterfactual scenario against which the loss was to be judged. The Court explained its approach as follows:

*"Where the policyholder has therefore prima facie established a loss caused by an insured peril, it would seem contrary to principle, unless the policy wording so requires, for that loss to be limited by the inclusion of any part of the insured peril in the assessment of what the position would have been if the insured peril had not occurred."*

As construed by the Court, the operation of the trends clauses made no difference to the quantum of the claims, except, at least in principle, in certain scenarios where there was a downturn in turnover prior to the date on which the various elements of the insured peril were present.

### *Three categories of clause*

The Court applied its approach to construction (regarding causation and trends clauses) to each of the three categories of clauses and also considered the clause-specific issues in each case. In addition to the matters discussed above, the following broad conclusions can be drawn from the judgment in respect of the three categories:

- *Disease Clauses.* Generally, there would be cover under most of these clauses, provided that the insured could show that there was an instance of the disease within the specified vicinity (the Court noted that vicinity could, in some instances, potentially embrace the whole country).

- *Hybrid Clauses and Denial of Access Clauses*. The Court favoured the insurers' arguments regarding a number of issues relating to these two categories of clause. So, for example, where the clauses required that the denial of access or closure of premises was enforced (or similar) it was determined that a policyholder must demonstrate mandatory, legally enforceable measures requiring such closure; government guidance would not suffice. Similarly, where policies required a prevention of access or use, there would be no cover if the insured continued to have some access to its premises for the purposes of running its business (for example, for some of the wordings, if a pub which had previously offered takeaway services continued to do so during the pandemic, it would not have been prevented from accessing or using its premises such that it would not have cover). Overall, the availability of cover under the hybrid and denial of access clauses is likely to vary significantly depending on the particular wordings and to be harder to establish on the facts.

## The future

The decision in the test case is, of course, of great significance, but questions remain as to its legal and practical effects for policyholders, insurers and reinsurers.

There is first the matter of an appeal. The FCA, a number of the insurers and one of

the interveners have made "leapfrog" applications to appeal directly to the Supreme Court. Given the significance of the decision and its potential effects beyond the immediate COVID-19 losses, it seems likely that at least some aspects of the case will be reviewed by the Supreme Court.

Even without an appeal, issues not fully addressed by the test case might be litigated: for example, how policyholders can prove that there had been an instance of COVID-19 in the vicinity of their premises (the "prevalence" issue). Moreover, what the Court has provided is only general guidance and so whether there is cover will have to be reviewed on a claim-by-claim basis in the light of the particular wording and facts. With respect to the effect of the underlying claims on reinsurance, consideration will have to be given to matters such as their aggregation and the application of hours clauses. The provisions of reinsurance policies will have to be carefully reviewed to determine the scope of cover.

At best, all that can be said is that the test case has made a start in resolving the issues, but there is a long way to go.