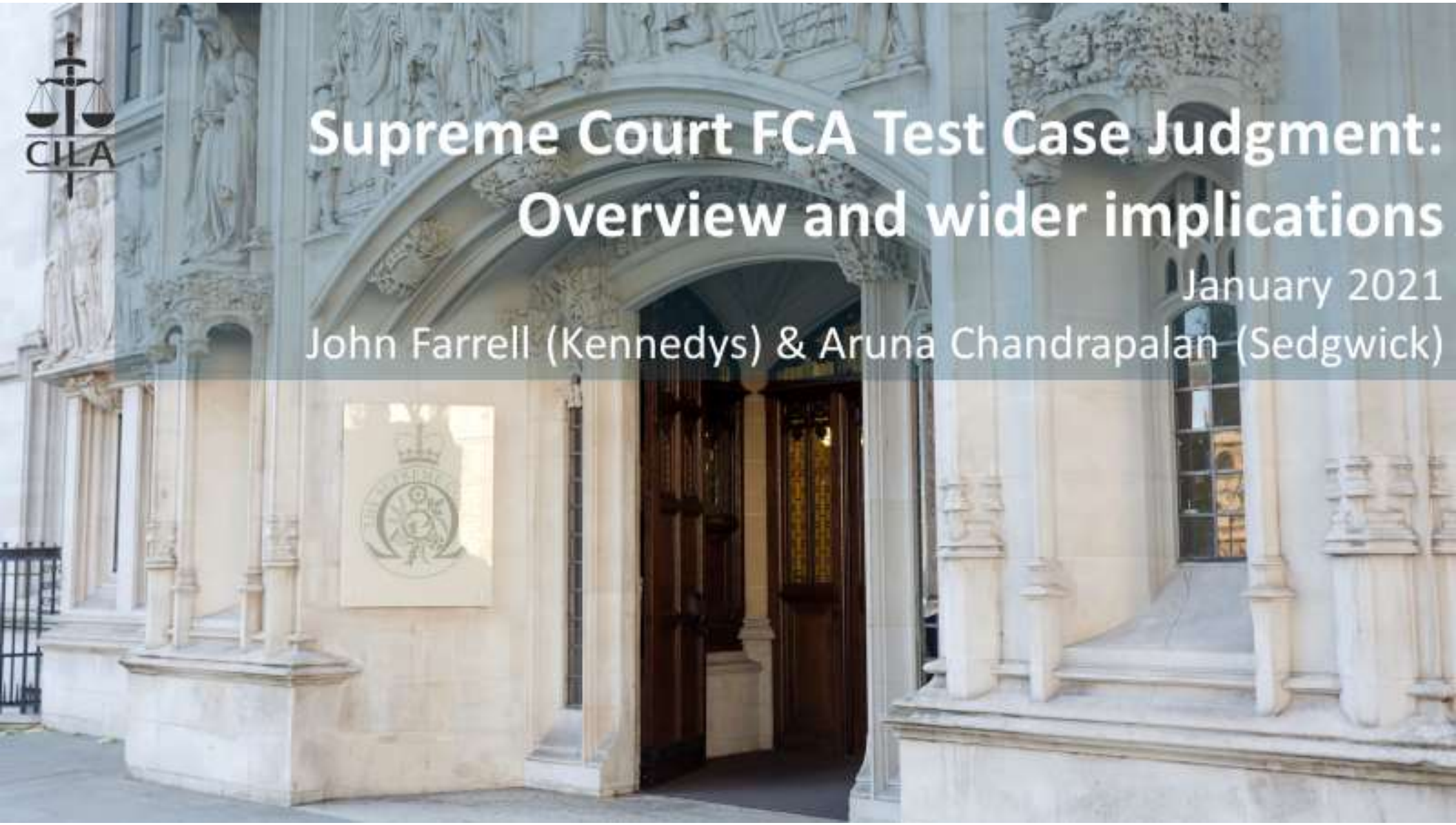

Supreme Court FCA Test Case Judgment: Overview and wider implications

January 2021

John Farrell (Kennedys) & Aruna Chandrapalan (Sedgwick)

Agenda

OVERVIEW
DISEASE CLAUSES
PREVENTION OF ACCESS & HYBRID CLAUSES
TRENDS CLAUSES
ORIENT EXPRESS
WHAT WAS NOT CONSIDERED?
WIDER IMPLICATIONS?
Q&A SESSION

OVERVIEW

Purpose and background to the Test Case

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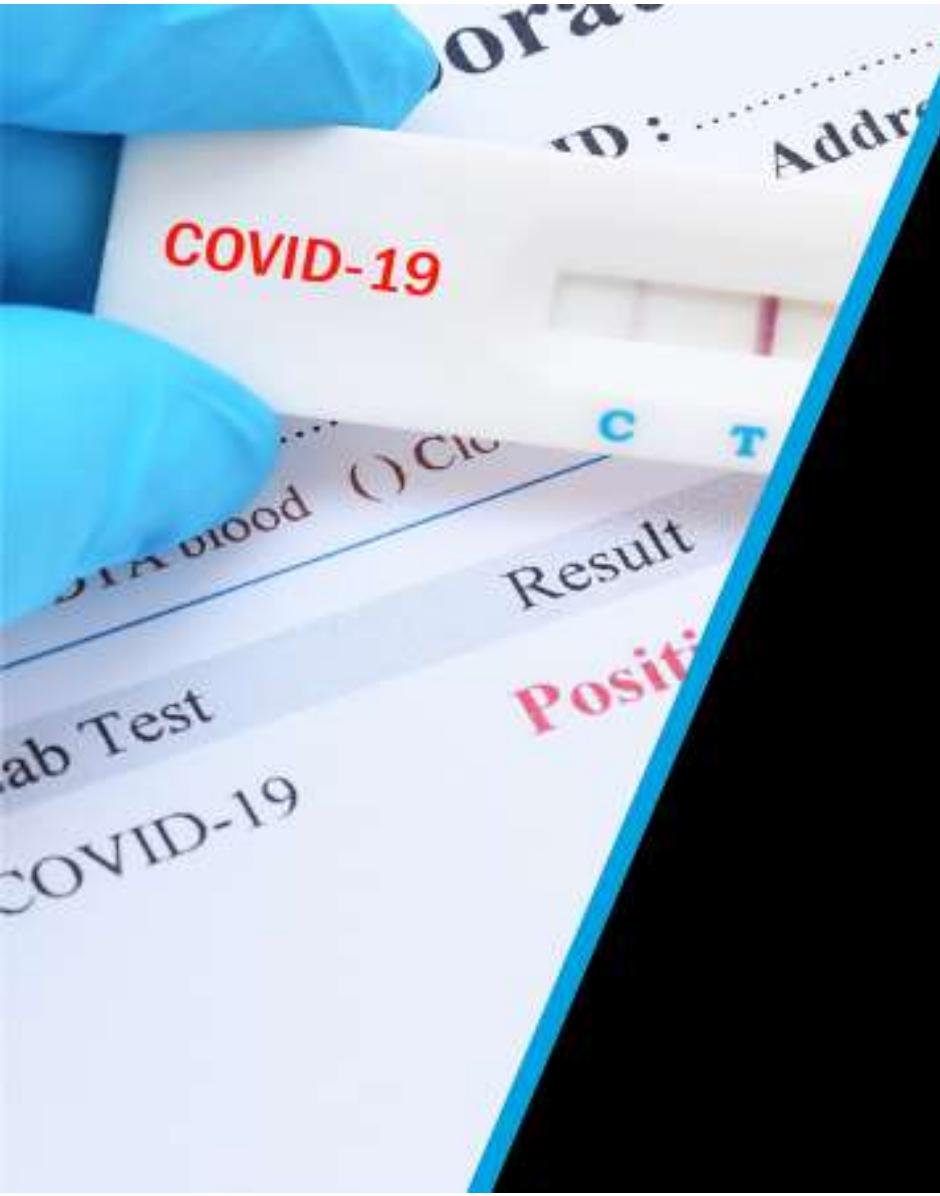
Background

- In May 2020, the FCA announced its intention to bring a test case in the High Court to seek legal clarity on the meaning / effect of selected BI policy wordings.
- FCA acted on behalf of "all policyholders" generally.
- Eight defendant insurers were parties to the proceedings. Note – judgment is only strictly binding on those insurers.
- 21 representative sample wordings including various non-damage "Disease", "Hybrid", and "Prevention of Access" clauses.
- The parties agreed certain facts which could support policy construction and agreed on the types of typical policyholder for each policy.
- The High Court decision, delivered in September 2020, largely found in favour of the FCA.
- The parties appealed by way of "leapfrog" to the Supreme Court (SC).

Interpretation of insurance contracts

- The SC reaffirmed that an insurance policy, like any other contract, must be interpreted objectively.
- Evidence about what the parties subjectively intended or understood the contract to mean is not relevant.
- Suggestion by the SC that the nature of the insured is relevant to this enquiry. In this case, the insureds were principally SMEs.
- English law approach:
  - Loss proximately caused by a combination an insured peril and uninsured peril = insured
  - Loss proximately caused by a combination of an insured peril and excluded peril = not insured
  - Exclusions designed to define the cover



DISEASE CLAUSES

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Disease clauses

- Clauses that provide cover for BI loss caused by the occurrence of a notifiable disease at or within a specified distance of insured's premises.

- The High Court found that (other than two exceptions) the peril insured under these clauses was COVID-19 as a whole, including the public and governmental responses to it, as long as there had been at least one occurrence of the disease within the relevant policy area.

- The Supreme Court disagreed, finding that:
  - The clauses provide cover for occurrences of disease within the relevant policy area.
  - Each individual case of COVID-19 was a separate occurrence.
  - The clause does not cover business interruption for cases outside the radius.

Disease clauses

- HOWEVER:
  - Each occurrence (individual case of COVID-19) was a separate and equally effective cause of the Government action in response to COVID-19. One case is therefore a trigger.
  - Insurers relied on the "but for" test i.e. the loss would have been suffered by the insured in any event irrespective of the insured peril and accordingly the insurance should not respond.
  - SC held that in circumstances where multiple events cause a result, but none of them is individually sufficient or necessary to do so, the "but for" test is inapplicable.
  - Therefore, it is sufficient for an insured to show that the BI loss was a result of Government action taken in response to cases of disease which included at least one case of COVID-19 within the relevant radius.

Prevalence of Disease

- Burden of proof is with the Policyholder

- Evidencing prevalence of disease
  - Specific evidence
  - NHS Deaths Data
  - ONS Death Data
  - Reported Cases
  - Averaging methodology / Undercounting

- Postcode Checker: https://coronavirus.data.gov.uk/

PREVENTION OF ACCESS & HYBRID CLAUSES

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Prevention of Access and "Hybrid" clauses

- POA clauses provide cover for BI losses resulting from public authority action. "Hybrid" clauses combine the elements of disease and POA clauses.
- **"Restriction imposed"** can be imposed on potential customers and not just the insured and its use of the premises.
- **"Inability to use"** may include an insured's inability to use either the whole or a discrete part of its business.
- **"Prevention of access"** may include prevention of access to a discrete part of the premises.
- **"Interruption"** means business interruption generally, and is not limited only to a complete cessation of the insured's business.

Prevention of Access and "Hybrid" clauses

- The Hiscox hybrid clause provides cover for (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 insured's business

- The SC found that such clauses indemnify against the risk of (A)-(D) acting in combination to cause the BI loss.

- The cover is triggered regardless of whether the loss was concurrently caused or contributed to by other consequences of the COVID-19 pandemic (being the underlying or originating cause)

Prevention of Access and "Hybrid" Clauses

Category	Businesses Affected
Category 1	Restaurants, cafes, bars and public houses
Category 2	Cinemas, theatres, nightclubs, museums, galleries, etc
Category 3	Essential shops such as food retailers, petrol stations, pharmacies, dental and health services
Category 4	Other retailers that were not "essential shops"
Category 5	Businesses not mentioned at all (accountants, construction, manufacturers, etc)
Category 6	Businesses providing holiday accommodation.
Category 7	Places of worship, nurseries and schools

- Prevention of Access will not cover business categories that were not required to close:
  - **Category 3** (explicitly allowed to stay open)
  - **Category 5** (not explicitly referred to in the regulations)

Prevention of Access & "Hybrid" Clauses

- Prevention of Access Clauses
  - Wording specific
  - Prevention / hinderance (wider cover)
  - Period of interruption

- Restrictions – general measures v specific measures
  - Restrictions imposed meant something that was mandatory
  - Enforced closures does not include general measures
  - Category 3 category 5 unlikely to suffer inability to use due to social distancing regulations

- Inability to use a discrete part of the business/premises
  - department store closing all parts of the store except its pharmacy

- Interruptions can be partial, does not have to be complete (takeaway example)
  - HC held that continuation of service offered pre Covid meant there was no prevention of access
  - SC disagreed

TRENDS CLAUSES

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“Trends” clauses

- Trends clauses provide for a BI loss to be quantified by reference to what the performance of the business would have been had the insured peril not occurred.

- The SC held:
  - They are solely part of the quantification machinery of the policy.
  - They should be construed consistently with insuring clauses.
  - They should not be construed as exclusions.

- The trends for which adjustments to the policy indemnity should be made do not include trends or circumstances arising out of the same originating cause as the insured peril (i.e. the COVID-19 pandemic).

- For the same reasons, BI loss cannot be adjusted to account for pre-policy trigger trends referable to the COVID-19 pandemic.

"Trends" clause

- Trends clause should be unconnected with the Insured peril.

  Disease clauses - what results would have been achieved by the business during the indemnity period but for COVID-19.

  PoA and hybrid clauses - what the results of the business would have been if none of the elements of the insured peril had occurred.

- Trends clause should not be interpreted to reduce insured cover.
- Pre-trigger losses.
- Hickmott, Interruption Insurance: Proximate Loss Issues (1990)
- Riley
  - reference to floods in Cockermouth in Cumbria in November 2009
  - Orient-Express case
- Court's worked example

"Trends" Clause – Court Worked Example

- Calculating loss:
  - identify which activities of the business were interrupted by the insured peril
  - identify the income actually earned from those activities during the period of interruption (zero, as shop was closed)
  - actual income is compared with the standard turnover (adjusted to reflect any trends or circumstances ***which are unconnected with the insured peril and not circumstances***) interruption (zero, as shop was closed)

- Court did not consider:
  - Increased sales online
  - Alternative trading clause

ORIENT EXPRESS

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The *Orient-Express* decision

- The *Orient-Express* decision found that a hotel damaged by a hurricane could not claim BI losses which the hotel would have suffered anyway as a result of damage to the wider area caused by the same hurricanes (Katrina and Rita). The "but for" test in action.

- The SC found that the decision was wrongly decided and should be overruled.

- Lord Leggatt (who was a member of the arbitral tribunal on *Orient-Express*) and Lord Hamblen (who was the judge who heard the appeal from the arbitral tribunal) overturned their own decision.

- More graceful than Lord Westbury who said:

  "I can only say that I am amazed that a man of my intelligence should have been guilty of giving such an opinion"

WHAT WAS NOT CONSIDERED?

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What the Supreme Court did not consider

- Whether contamination of property by SARS-CoV-2 constitutes physical damage
- Whether loss of use due to COVID-19 can amount to PD (but note the HC decision of *TKC London v Allianz*)
- Wordings covering only a disease occurrence at the insured premises
- The POA clauses that the HC had earlier found do not respond to the COVID-19 pandemic
- Adjustment or loss quantification, save for the "trends" clauses
- Aggregation issues
- Loss of rent claims

WIDER IMPLICATIONS?

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Wider Implications?

- The optics.
- Approach of the Courts
- Insured perils and exclusions
  - The missing “only”
  - Location and drafting of exclusions
- Who are the insureds?
- A new caveat on the “but for” test. Does this matter?

Wider Implications?

- Causation/application of trends clause.
  - Natural disasters
- Aggregation
  - deductibles/waiting periods
  - reinsurance
- Damages for late payment of claims
- Claims in overseas jurisdictions

QUESTIONS AND DISCUSSION

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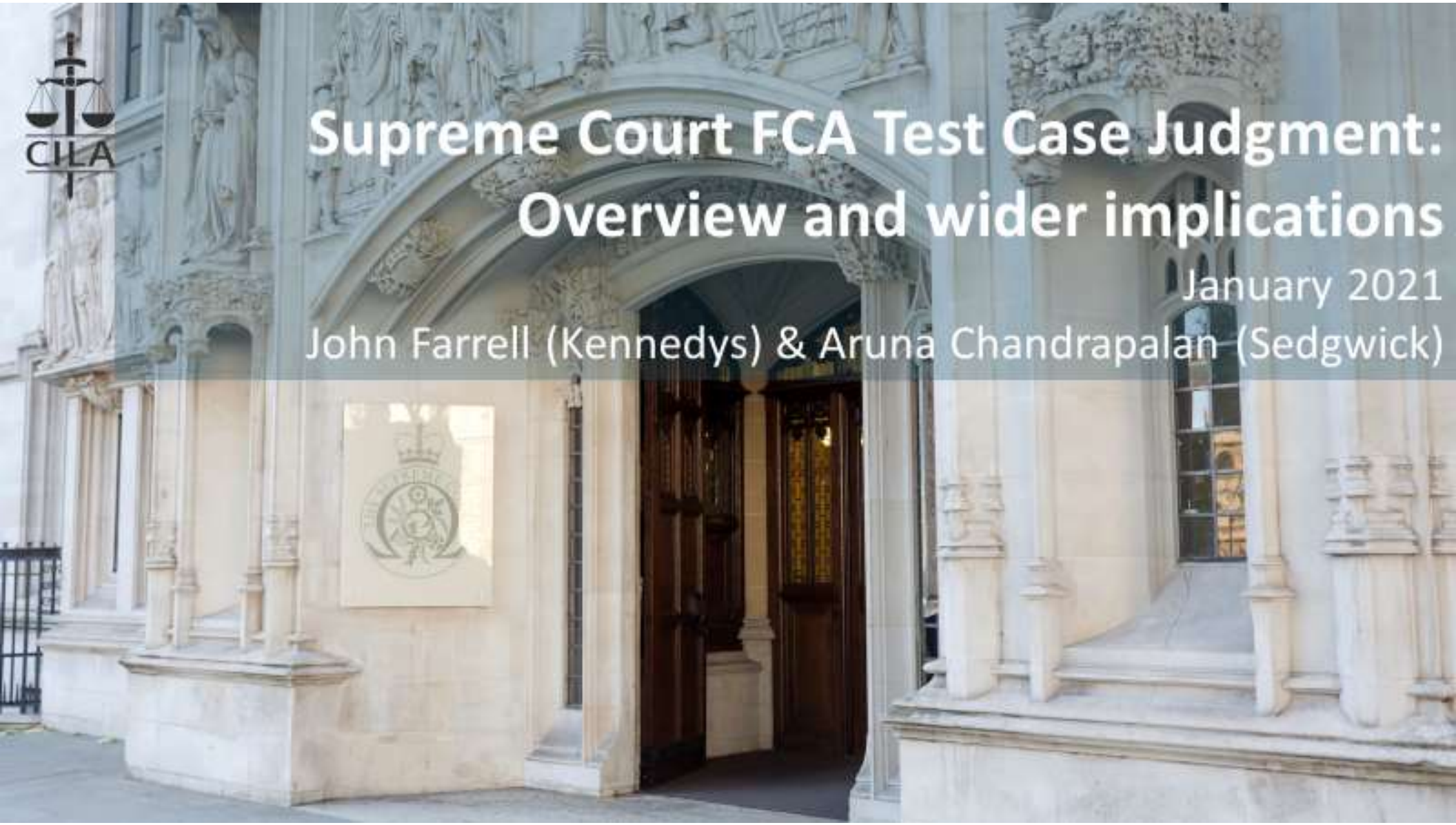

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