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Business shutdowns and COVID

Is the Supreme Court's BI judgment really the salvation to UK business that the media would have us believe?

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The recent and much anticipated judgment of the Supreme Court in the FCA Business Interruption (BI) test case has been extensively considered in the legal and insurance press. The case has confirmed Insurers' obligation to provide cover for many non-damage BI insurance claims arising from the Covid 19 pandemic. It does, however, leave many questions unanswered and raises issues of concern for the insurance industry as a whole. In this article we consider the wider implications of the judgment for Insurers and brokers alike.

The case

In May 2020 the FCA instigated legal proceedings to clarify the scope of cover under a sample of BI policy wordings. The High Court considered the relevant provisions in 21 wordings, comprising a mix of disease extensions, prevention of access/public authority extensions and hybrid clauses. in the judgment handed down on 15 September 2020, the High Court (broadly speaking) concluded that disease or hybrid clauses might provide some cover, but that denial of access extensions generally would not.

The FCA and six of the Insurers appealed many of the High Court's findings. The appeal was 'leapfrogged' to the Supreme Court and heard in November 2020. Judgment was handed down on 15 January 2021.

The judgment of the Supreme Court

What appears below is not intended to be an exhaustive summary of the case as that has been very well covered elsewhere. But, essentially:

Disease extensions

An 'occurrence' of a 'Notifiable Disease' means 'each individual case sustained within the relevant vicinity/geographical area'. *But* cover is not confined to losses arising *only* from cases within the relevant vicinity; instead, *all* affects to the business of the Covid 19 outbreak should be taken into account. This is because of the court's analysis of causation (see below).

The High Court had previously used different logic (based around a very broad interpretation of the word 'vicinity') to reach ostensibly the same conclusion, so the Supreme Court's determination on this issue does not materially alter the position from a practical perspective.

Prevention of access/hybrid extensions

BI 'prevention of access' wordings generally include a requirement for there to have been an enforced closure of business premises for cover to be triggered. The Supreme Court concluded that an instruction to close given by a public authority might well fulfil the requirements of an enforced closure, regardless of whether or not it has "the force of law".

Cover is not dependent on an inability to use the whole premises and can instead be triggered '*where a policyholder is unable to use the premises for a discrete business activity or is unable to use a discrete part of the premises for its business activities*.

This has the effect of providing cover where premises have been closed for some but not all purposes, the obvious example being a restaurant that can no longer serve 'eat in' diners but can nevertheless continue to offer a takeaway service.

This aspect of the judgment is a marked departure from the High Court's determination, which all-but closed the door to claims based around 'denial of access' provisions.

Causation

It is here that the Supreme Court's judgment differs most significantly from that of the High Court. The Supreme Court held that "*all the individual cases of Covid 19 which had occurred by the date of any Government measure were equally effective "proximate" causes of that measure (and the public response to it)".* It was therefore sufficient for a policyholder to show that there was at least one case of coronavirus within the geographical area covered by the clause at the time of any relevant government measure for the policy to be engaged in respect of Covid 19 as a whole. The court dismissed the Insurers' argument that the "but for" causation test should apply, whereby one would look to cover only such losses as flowed *directly* from the actual cases of Covid 19 in the vicinity.

The Supreme Court concluded that it was appropriate to depart from the "but for" test where, as here, it would provide an inadequate, unjust or perverse result. And in this case, to achieve what it viewed as the right result, the Supreme Court looked at causation on a concurrent basis. That is to say that, in their determination, it is possible for a whole series of events to combine to cause a particular result, and for the consequences of that result to fall for cover, even if some of those events are not insured perils and even if the insured perils on their own would be incapable of causing that result.

This explains why their lordships expressly overturned the Orient Express case as mentioned below.

Trends clauses

Trends clauses *"should not be construed so as to take away cover provided by the insuring clauses…and…the trends and circumstances for which the clauses require adjustment to be made do not include circumstances arising out of the same underlying or originating clause as the insured peril*".

In everyday speak, what this means is that Insurers cannot argue that, even if the policyholder's premises had remained open, significant losses would have been incurred anyway due to the lack of passing trade and other government restrictions on the wider public (see the discussion on Orient Express below).

Orient Express Hotels Ltd v Assicurazioni Generali SPA

In the Orient-Express case an arbitration panel decided that cover for a New Orleans hotel damaged in Hurricane Katrina did not extend to any business losses that would have been suffered in any event as a result of the wider havoc wreaked upon the city of New Orleans by the hurricane. A clear adaption of the 'but for' test for causation.

Despite the fact that two of the lords in the Supreme Court presided over the Orient Express case, the case was expressly overruled as being bad law, thereby going further than the High Court (who had simply declined to follow its logic).

Short term impact

The Supreme Court's judgment is being hailed as a victory for the policyholder. And, given that the FCA – having already largely succeeded at first instance - appears to have been successful on almost all of the elements of the High Court judgment which it appealed, that would seem to be a fair assessment on the face of it.

However, on closer examination, the position is in fact not so clear-cut.

The figures at first glance are certainly stark; there are approximately 370,000 BI policyholders insured in the London Market, underwritten by 60 Insurers across approximately 700 different policy wordings.

Comments from the ABI appear to suggest, however, that the vast majority of those policies provide cover for physical damage to premises only, with only a comparatively small number of businesses opting to purchase any form of cover that includes business interruption due to a notifiable or infectious disease. It was established early in the pandemic that Covid 19 did not cause physical damage to premises, and, as such, it can reasonably be concluded that by far the majority of BI policies will not be triggered by the pandemic at all.

Indeed, the FCA's own 'Dear CEO' letter sent on 22 January 2021 in the wake of the Supreme Court's verdict confirms that *"It remains the case that most SME BI policies are focused on property damage and only have basic cover for BI as a consequence of property damage, so are unlikely to pay out in relation to the Covid-19 pandemic and its effects."*
The impact of the judgment narrows even further when one considers that the FCA's Test Case focused on three so-called 'non-damage' extensions that are present in *some* market BI wordings: disease-based extensions, denial of access-based extensions and hybrids. All these extensions are typically very heavily sub-limited in the cover, tending to have ceilings of between £25,000 and £100,000 which is often aggregated across the policy term.

At first instance, the insurance market succeeded in establishing that many of the clauses under scrutiny would be highly unlikely to be triggered in respect of Covid 19 losses. Whilst some of the High Court's reasoning was appealed to the Supreme Court, not all of it was and so many of the wordings that were found not to respond will not do so. This is particularly the case in relation to the 'denial of access' style wordings.

Of the disease-based extensions, many of the market's wordings provide cover only for diseases which appear on a prescriptive list. In respect of these extensions, and given that Covid 19 was not on any list at the material time, it is clear that cover for Covid 19 will not be forthcoming. These policies therefore fell outside of the scope of the FCA Test Case and policyholders carrying cover with this trigger will be disappointed.

Given what appears above, it seems that the Supreme Court's judgment actually focused on a very narrow section of the BI market and, as such, the immediate impact on BI Insurers may not be quite as great as the media might have us believe.

Establishing that the policy will respond in principle is just stage one. As Insurers work to apply the test case decision to individual losses against different policies, inevitably further issues will arise. As noted above, there are said to be approximately 700 BI wordings circulating in the market, spread across 60 different carriers, all with their own separate wordings and idiosyncrasies. Application of the Supreme Court's ruling to the numerous different wordings will be no mean feat – disagreements will almost certainly arise as regards the appropriate period of indemnity, coverage for losses incurred under the Tier system and/or aggregation arguments around the second and third national lockdowns.

There remain many issues to be ironed out.

The FCA has said that it will publish a set of Q&As for policyholders to assist their understating of the case, which will provide some help. And, as is clear from its 'Dear CEO' letter dated 22 January 2021, it will also be putting considerable pressure on insurers to deal with all outstanding claims as quickly and expeditiously as possible. Nevertheless, we foresee a long and bumpy road ahead.

Wider impact

Whilst the judgment has been handed down in the context of a BI insurance case, it would be naïve to assume that its ramifications will be limited to that section of the UK insurance market. Indeed, the ruling shines a spotlight on the mounting tension between insurers and regulators, whereby regulators impose their mantra of ever greater consumer protection upon a free insurance market that is becoming decreasingly willing to tolerate it. Insurers will argue that regulators are too often intervening in order to achieve a different outcome to the one that was ever contemplated within the terms of the insurance contract and the risk ratings and premiums applied at inception. And this breeds uncertainty, which makes for a nervous market. When allied to the internal pressures that insurers are already experiencing at the hands of Lloyds to more carefully consider their exposures, it is little surprise that we are seeing more insurers exiting the market than are joining it at the current time.

In terms of the judgment itself, the concept of concurrent causation also arguably opens insurers up to broader liabilities than might have been the case under a 'but for' analysis. Whilst it seems that the logic in *Wayne Tank* survives (and so, where a loss has two causes one of which is excluded from cover, insurers will continue to be able to exclude the claim – for now), the indirect nature of the concurrent test will undoubtedly widen the scope for cover beyond the relatively narrow and direct 'but for' consequences, and will add yet more uncertainty into the mix as a result.

Insurers will need to review their wordings and reintroduce a level of certainty that will enable their underwriting decisions to be made with a higher degree of confidence than currently exists. After a golden age of 'user friendly' policies with crystal marks for clarity, we can expect much tighter, more prescriptive and more detailed wordings into the future as a backlash to this decision, with fewer insurers being willing to underwrite them at considerably higher cost. Not really the win for the consumer after all…

What next for insurers?

The Supreme Court's decision represents the 'final resolution' of the proceedings thus triggers the final stage of the FCA's expectations of Insurers as set out in the guidance published in June 2020. Insurers are now obliged to:

1. Update to policyholders individually where claims/complaints are dependent on the outcome of the test case, explaining the outcome. This should be done no later than 22 January 2021. This is likely to be difficult given the remaining uncertainties that we have referred to above (as regards policy year, losses arising subsequent lockdowns etc.) and will require a sensitive, well-considered approach.

2. Handle and assess all outstanding potentially affected claims and potentially affected complaints in line with ICOBS 8 and DISP and apply judgment in the test case.

3. Reassess cases previously rejected to be completed and notified to policyholders

   There is no obligation to review any claims or complaints previously settled on a full and final basis, nor to review complaints that have been referred to the Financial Ombudsman Service.

What about insurance brokers?

Insurance brokers are likely to be facing two significant challenges at the moment.

First, for those clients that have BI cover, there will be an exercise to be undertaken in evaluating all of the applicable wordings to establish whether their clients fall within the successful categories in the Supreme Court's judgment. This will need a technical analysis of many of the 700 wordings followed by an application of those wordings to the facts of the individual cases. It will also need the broker to work with the FCA's Proof Guidance, which policyholders will need in most cases in order to establish the presence of Covid 19 within any geographical location that is needed to trigger the cover.

Secondly, where clients do not have BI cover (or where they do but their claims will not trigger their BI cover), brokers are likely to face disgruntled clients eager to lay blame. The FOS were already overwhelmed with Covid 19 related complaints before the FCA announced its test case and, whilst the Supreme Court's decision will have been met with a sigh of relief by insurance brokers (and their PI insurers) as the lesser of many evils, it won't have removed the spectre of negligence claims entirely. Client complaints are inevitable, and processes and procedures will be needed to manage the anticipated volume over the coming months.

Comment

The judgment of the Supreme Court undoubtedly marks a landmark moment for BI policyholders with specific non-damage extensions to their cover.

However, there won't be as many successful claims as is being touted. And we anticipate some interesting debate in the months to come as the situation continues to unfold. Managing the expectation of clients whose cover will not respond will not be easy, and dealing with the various coverage issues and other technicalities that the Supreme Court did nothing to resolve will be equally trying. As always, the judgment is likely to throw up more questions than answers, and significant resources are likely to be needed over many months yet to drill down into the individual problems and concerns that will remain. There will be an immediate backlash from the insurance industry; insurance will be harder to get and will cost more when it is available. But the wider ramifications of the judgment – and the increased intervention of the regulators – will only emerge over time.

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