SLAUGHTER AND MAY/

INSURANCE BRIEFING NOTE

JANUARY 2021

BUSINESS INTERRUPTION TEST CASE

SUPREME COURT JUDGMENT

OVERVIEW

On 15 January 2021, the Supreme Court handed down its judgment in the appeals of the test case on business interruption (**"BI"**) insurance (the "**Judgment**").

This substantially allows the FCA's appeal and dismisses the Insurers' appeals. In doing so, the Supreme Court has developed the law of concurrent causation and overturned the *Orient Express* case[1], a leading authority on BI insurance claims.

We advised an insurer party to the test case and are advising a number of our insurance clients on BI matters relating to COVID-19, including the implications of the Judgment.

BACKGROUND

The Supreme Court hearing was held on 16-19 November 2020, following "leapfrog" appeals from the High Court judgment handed down on 15 September 2020.

The Financial Conduct Authority (**"FCA"**), for the benefit of policyholders, had used the Financial Markets Test Case Scheme to bring an expedited hearing in the High Court in July 2020. Given the importance of the issues raised, the case was heard by a court of two judges, Flaux LJ and Butcher J. It was the first case to proceed under the Scheme, which enables a claim giving rise to issues of general importance to financial markets to be determined in a test case where immediately relevant and authoritative English law guidance is needed, without the need for a specific dispute between the parties.

The FCA was acting together with defendant insurers pursuant to a Framework Agreement, in order to resolve uncertainty in the market around how certain non-damage BI coverage clauses should respond to measures taken in response to COVID-19. The parties agreed a mutual objective for the test case to "*achieve the maximum clarity possible for the maximum number of policyholders (especially, although not solely SMEs) and their insurers consistent with the need for expedition and proportionality*".

The High Court had previously decided largely in favour of the FCA in relation to "disease" clauses, which require the occurrence or manifestation of a notifiable disease within a specified vicinity of the insured premises. It had also generally preferred the FCA's arguments in relation to "hybrid" clauses, which refer both to restrictions imposed on the premises and to the occurrence or manifestation of a notifiable disease, and in relation to some of the so-called "prevention of access" clauses.

The High Court had, however, agreed with the arguments of the insurers that a number of "prevention of access" clauses provided a narrower, more localised form of cover, which would not respond to the measures introduced by the UK Government at a national level in response to the COVID-19 outbreak. The FCA did not appeal this aspect of the High Court's decision.

Appeals were made to the Supreme Court by the FCA, six of the Insurers and one of the interveners.[2] A summary of certain key aspects of the Judgment is set out below.

THE SUPREME COURT JUDGMENT

Lord Hamblen and Lord Leggatt gave the main judgment, with which Lord Reed agreed. Lord Briggs gave a separate concurring judgment, with which Lord Hodge agreed. The Judgment will also be distilled into a set of declarations.

The Supreme Court allowed the FCA's appeal (and that of the intervener), albeit for certain grounds on the qualified terms set out in the Judgment. Whilst the Supreme Court accepted some of the arguments made by Insurers, in no case did this affect the overall outcome of the appeals.

The Supreme Court addressed the issues arising on the appeals under the following headings.

Disease clauses

The Supreme Court ultimately reached a similar conclusion to the High Court about the scope of cover, due to its analysis on causation (see below).

[1] *Orient-Express Hotels Ltd v Assicurazioni Generali SpA* (trading as Generali Global Risk) [2010] EWHC 1186 (Comm); [2010] Lloyd's Rep IR 531.

[2] The Insurers are Arch, Argenta, MS Amlin, Hiscox, QBE and RSA. The intervenor is Hiscox Action Group. Zurich and Ecclesiastical did not appeal, but Zurich was a respondent to the FCA's appeal.

It did not, however, accept the High Court's reasoning that such clauses provided cover for all BI losses resulting from COVID-19, provided there had been an "occurrence" (meaning at least one case) of the disease within the specified vicinity. Rather, the Supreme Court accepted the Insurers' arguments that: (i) each case of illness sustained by a person as a result of COVID-19 is a separate "occurrence"; and (ii) "disease" clauses only cover BI losses resulting from cases of disease which occur within the specified vicinity, which are to be treated as the insured peril.

Prevention of access and hybrid clauses

Force of law - The Supreme Court rejected the High Court's interpretation that a requirement for a "restriction imposed" (or similar) is satisfied only by a measure expressed in mandatory terms which has the force of law. Rather, it held that an instruction given by a public authority may be a "restriction imposed" if: (i) it is in anticipation, or carries the imminent threat, of legal compulsion; or (ii) it is in mandatory and clear terms that require, and would reasonably be understood to require, compliance without recourse to legal powers. The Supreme Court suggested that the latter is likely to arise only in situations of emergency (such as the current pandemic). Whilst not ruling on individual measures, the Judgment indicated that the argument is stronger in relation to specific measures (such as instructions in mandatory terms for certain businesses to close given by the Prime Minister on 20 March 2020) rather than more general measures.

Total closure - The Supreme Court agreed that the phrase "inability to use" requires inability rather than hindrance of use to be established. However, it went further than the High Court by holding that this may be satisfied 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. The Judgment applied similar reasoning to interpret requirements for a "prevention" or "denial" of access.

Causation

A key issue before the Supreme Court was the causal link between BI losses and occurrence of notifiable disease. In particular, whether the national Government restrictions could (legally) be said to be caused by an occurrence of COVID-19 within the specified vicinity even if they would have been imposed in any event as a result of multiple occurrences outside the vicinity (which were, being outside the vicinity, also outside the insured peril, as interpreted by the majority).

The Judgment overturned the High Court's primary analysis that COVID-19 was "*one indivisible cause*" of BI losses. The Supreme Court nevertheless held, consistent with the High Court's alternative analysis, 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 of the public response to it). It follows that it is sufficient for a policyholder to show that at the time of any relevant Government measure there was at least one case of COVID-19 within the specified vicinity covered by the insuring clause, and the causal effects of such occurrence(s) will include the effects of restrictions imposed by the Government in response to COVID-19 more generally. The Supreme Court found that the parties could not reasonably be supposed to have intended that cases of COVID-19 outside the vicinity could displace the causal effect of cases of the disease within the vicinity.

In doing so, the Supreme Court rejected the Insurers' arguments on 'but for' causation, explaining that this concept is sometimes inadequate. It effectively changed the law to expand the concept of concurrent proximate causation, indicating that there can be situations (such as the present case) where a significant number of multiple events all cause a result, even though none of them was individually either necessary or sufficient to do so. As Lord Briggs observed, whilst this is based on the application of the existing principle of concurrent causation, it is "*an extension of it into new territory*".

The Judgment also dismissed the Insurers' argument that aggregation of cases of the disease means that the overwhelmingly dominant cause should be viewed as cases of COVID-19 outside the specific vicinity – the Supreme Court considered this "weighing" approach to be unworkable and unreasonable.

In respect of "prevention of access" and "hybrid" clauses, the Supreme Court held that BI losses are covered only if they result from all the elements of the risk covered by the clause operating in the required causal sequence. However, the fact that such losses were also concurrently caused by other (uninsured but non-excluded) consequences of the COVID-19 pandemic does not prevent them from being covered, provided that the insured and non-insured perils were of approximately equal efficiency.[3] These consequences are not separate and distinct risks, but rather are inextricably connected with the insured peril as they all arise from the same underlying and originating cause.

Trends clauses

The Judgment removed the scope for trends adjustments for any COVID-19 related downturn prior to cover being triggered, which had been present in the High Court decision. The Supreme Court held that these clauses should not be construed so as to take away cover provided

[3] The example given in the Judgment where there would be no cover was of a travel agency which had access to its premises prevented by law, but the sole proximate cause of its losses was in fact the restriction on travel imposed in response to COVID-19 generally, and not the specific loss of walk-in trade.

by the insuring clauses, and that adjustments should not be made for related circumstances arising out of the same underlying or originating cause as the insured peril (in this case, other effects of the COVID-19 pandemic).

Pre-trigger losses

In accordance with its interpretation of the trends clauses, the Supreme Court held that adjustments should only be made to reflect circumstances affecting the business which are unconnected with COVID-19, not those that arise out if the same underlying or originating cause. This overturns the High Court's decision that permitted adjustments could be made under the trends clauses to reflect a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered.

Orient-Express decision

The Supreme Court concluded that the *Orient Express* case, which the Insurers' had relied on to support their arguments on causation of loss and the effect of the trends clauses, was wrongly decided and should be overruled. In doing so, Lords Leggatt and Hamblen (as arbitrator and judge respectively in the *Orient Express* case) overruled their own previous decision – professing to "*gracefully and good naturedly*" surrender "*former views to a better considered position*". That case, which was a leading authority on BI insurance, concerned BI losses arising from damage to a hotel in New Orleans from Hurricanes Katrina and Rita in 2005. The correct approach, the Lords indicated, would have been to exclude from the trends assessment anything which had the same underlying or originating causes as the actual damage (i.e. in that case, the hurricanes).

This confirms that the "but for" test is not always a necessary or determinative test in deciding issues of proximate causation, at least in the insurance context. It nevertheless remains a relevant test and, the Supreme Court acknowledged, an appropriate one to apply in most cases.

Lord Briggs' judgment

The major point of difference in Lord Briggs' minority judgment was that he agreed with the High Court's primary analysis of "disease" clauses, such that the COVID-19 pandemic is the insured peril and it is sufficient that it comes within the specified vicinity of the premises. The practical outcome was the same, though. His underlying driver was to find some workable analysis to avoid cover becoming "*illusory*", at the time it might have been supposed to be most needed by policyholders. Lord Briggs remarked that such an outcome would seem "*clearly contrary to the spirit and intent*" of the provisions of the policies in issue that provide cover for notifiable disease within the vicinity.

CLOSING REMARKS

Certain matters relating to how BI cover responds to the COVID-19 pandemic were explicitly out of scope of the test case. For example, the FCA did not argue that cover should be available under clauses that require damage to property or those that require the occurrence of disease at the insured premises (rather than within a wider vicinity).

The test case also relates principally to BI caused by the first national lockdown measures introduced across the UK in March 2020. Whilst the principles will also be relevant for issues of coverage of subsequent BI relating to COVID-19, including subsequent lockdowns and tier-based restrictions, there are aspects that it does not determine. This includes questions around aggregation of losses and applying policy limits, as well as the correct approach to BI losses arising from COVID-19 under reinsurance arrangements. Whilst there may be some guidance from the views expressed in the Judgment, the position in an inwards insurance context will not be determinative of the position for outwards reinsurance arrangements of insurers, which will give rise to different issues. This may not be the last judgment on this topic, given the potential for further disputes.

A broader point for insurers and other financial institutions is the significance of the FCA's intervention for the benefit of policyholders, through its first use of the Financial Markets Test Case Scheme. There is clearly the possibility of further similar action in the future, given that this intervention can be seen as a success for the FCA.

The Supreme Court also noted with some satisfaction that the Judgment had been obtained through this process in what, in legal terms, was a short timescale.

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