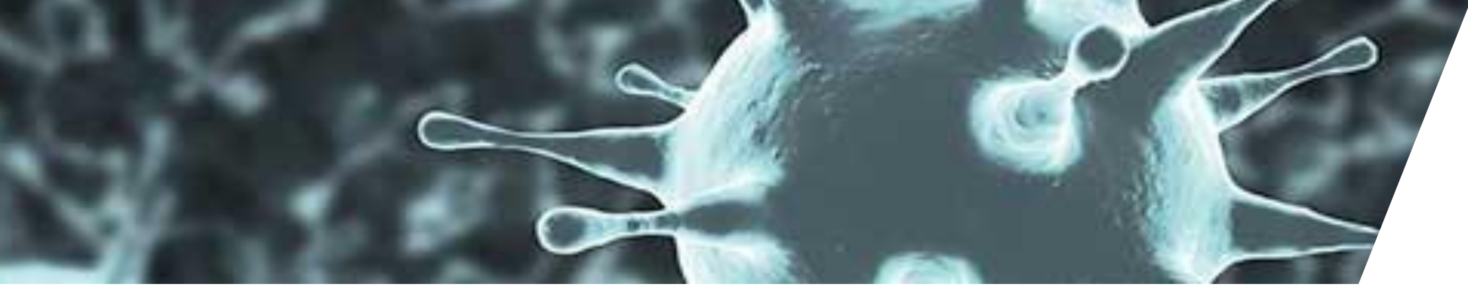

# Case Summary: FCA Business Interruption Test Case

## Introduction

On 15 September 2020, the High Court handed down its much-anticipated judgment from Lord Justice Flaux and Mr Justice Butcher in the FCA's business interruption test case which ran to 162 pages. The judgment is detailed and analyses a number of different policies. The purpose of this note is to set out some key points arising from the judgment as opposed to explaining at length the different decisions reached in respect of the various policies.

### The Facts

Some of the key facts, as found by the court, can be summarised as follows.

On 31 December 2019, the World Health Organisation ("WHO") was informed of pneumonia cases of an unknown cause in the city of Wuhan, China.

On 12 January 2020, the WHO announced that a novel coronavirus had been identified in samples obtained in China.

On 31 January 2020, the WHO declared the outbreak of COVID-19 a "*Public Health Emergency of International Concern*".

On 3 March 2020, the UK Government announced an "*action plan*" in response to COVID-19.

By 6 March 2020, COVID-19 was a notifiable disease in the UK.

On 11 March 2020, the WHO declared COVID-19 to be a pandemic.

On 16 March 2020, the UK Government published guidance in relation to social distancing and advised people to work from home where possible.

On 20 March 2020, the UK Government directed various businesses to close such as pubs and restaurants.

On 21 March 2020, the directions given by the UK Government a day earlier became law having been enacted as regulations.

On 23 March 2020, the UK Government announced lock-down including the closure of further businesses.

## Principles of Construction

The court explained that the ordinary principles of construction of contracts applied to insurance policies. Those principles were not in dispute, but the court helpfully explained some general principles including the following.

### Objective Intention

In determining how to construe a policy of insurance the court "*must ascertain what a reasonable person, that is, a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the contracting parties to have meant by the language used*". However, the court explained that in seeking to ascertain the meaning of an insurance policy the court must consider the policy as a whole and, depending on the nature, formality and quality of the drafting of the policy, give more or less weight to elements of the wider context in determining the objective meaning. They explained that whilst the court should consider the commercial consequences of different competing constructions that "*commercial common sense should not be invoked retrospectively, or to rewrite a contract in an attempt to assist an unwise party, or to penalise an astute party*" and, ultimately, in the event that clear and unambiguous language had been used it should be applied.

### The Absence of Exclusions

Generally, when construing the meaning of a contract the absence of words can be used to support a particular construction. However, in the case of an insurance policy that principle had little application in relation to the non-use of exclusions. The court said that if in a policy of insurance one cover is subject to an exclusion whereas another is not, the absence of that exclusion in relation to the latter cover is not decisive as regards its scope.

### Contra Proferentem

This is a "*rule*" which states that if the terms of a contract, including the terms of a policy of insurance, are ambiguous the ambiguity should be construed against the party which drafted it. The scope for the rule to apply is very limited at best. It had been argued that if an exclusion clause in a policy is ambiguous then it should be construed narrowly. The court said that contra proferentem "*if it still has any validity, can only apply if there is genuine ambiguity, which cannot otherwise be resolved by applying the ordinary principles of construction.*"

### Relevant Background

When construing an insurance policy, the court was only permitted to take into account facts or circumstances which existed at the time the policy was entered into and which were either known or reasonably available to both parties.

### Relevant Expressions

The court also referred to the principle that where an expression has been construed by a court previously the court next considering the same expression should construe it in the same manner. The logic of that principle is said to be that where a contract, including an insurance policy, has been drafted professionally the draftsman should be treated as having the earlier decisions of the courts in mind when deciding which words to use. This turned out to be an important principle in the case.

## Notifiable Disease Wordings

The court considered the meaning of different "*disease clauses*" contained in extensions to different business interruption policies underwritten by Argenta, QBE, MS Amlin, and RSA. Whilst each policy needed to be considered separately, the notifiable disease extensions in question shared common themes. That is to say, according to the court, in broad terms, the various extensions provided "*coverage 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*". The "*specified radius*" in each of the policies differed. For instance, in some the radius was set out in miles whereas in another it was said to be within the "*Vicinity*" (as defined in the policy) of the insured premises.

### The Insurers' Position

In summary, the insurers' position was that there was no cover under the extensions. Some key points advanced were as follows:

a. It was common ground that COVID-19 was a notifiable disease.

b. The extensions only covered against business interruption or interference "*proximately caused by a local outbreak*" of a notifiable disease being one within the specified radius or area from the premises.

c. There was a requirement of "*but for*" causation such that there would be no cover if but for an occurrence of COVID-19 within the specified radius of the insured premises there would still have been the same interruption. They argued as a result of the national measures implemented in response to COVID-19 the insured's business would still have suffered from the: (i) the impact of the UK Government's social distancing measures; (ii) any closure measures because they would have been introduced by reason of the occurrence or feared occurrence of COVID-19 in areas other than within the applicable radius from the insured premises.

### The FCA's Position

In summary, the FCA's position was that there was cover under the extensions because:

a. It was common ground that COVID-19 was a notifiable disease.

b. There was an "*occurrence*" of that notifiable disease within the applicable radius of an insured's premises when a person with COVID-19 was within the applicable radius of those premises.

c. From 16 March 2020 (or a later date to be determined by the court) there was interruption or interference with business given the UK Government's response to the pandemic including in relation to social distancing, self-isolating and lockdown etcetera. Alternatively, where businesses had been ordered to close from 23 March 2020 there was such interruption or interference.

d. The losses were sufficiently causally connected with the interruption or interference.

e. That such interruption or interference followed the occurrence of COVID-19 in that the interruption or interference would not have occurred had there been no COVID-19 outbreak or intervention by the UK Government.

### The Court's Decision

In summary, the court, for the most part, agreed with the FCA's position as regards the Argenta, MS Amlin, and RSA policies and one QBE policy. Some key points of the decision in this respect are as set out below.

## COVID-19 as a Notifiable Disease

The court noted and agreed it was common ground that COVID-19 was a notifiable disease for the purpose of the extensions and the outbreak of it was an "*occurrence*".

## The Insured Peril & Proximate Cause

Importantly, the court considered the insured peril was the "*composite peril of interruption or interference*" following an occurrence of COVID-19 and the response of the UK Government to that. They found there was a requirement for proximate causation to be proved as set out in section 55(1) of the Marine Insurance Act 1906, which had been discharged as COVID-19 and the response of the UK Government to that had been the dominant cause of the business interruption or interference.

## Sustaining or Diagnosis of COVID-19

In relation to policies that required an occurrence of COVID-19 within a specified radius, the court found that there had been such an occurrence "*when at least one person who was infected with COVID-19 was in the relevant area*". The court did not consider it necessary for the person to have been diagnosed with the illness where the definition of notifiable disease required the person to have "*sustained*" it and did not state the person had to have been *"diagnosed"* with it.

## The Locality Issue

Very importantly, the court did not agree that the proper construction of the policies was that the parties were not agreeing that there was cover for business interruption losses as a consequence of a notifiable disease **only** "*insofar as it was within the "relevant policy area"* but rather the correct interpretation was that there was cover for "*the business interruption arising from a notifiable disease of which there was an occurrence within the relevant policy area*". In other words, it was sufficient for the business to suffer interruption as a result of COVID-19 and the response to it provided there had been an outbreak in the area defined by the policy. It was not necessary for the interruption to be caused by a specific local outbreak itself.

The RSA policy required an outbreak within a "*Vicinity*" defined as being "*an area surrounding or adjacent to an Insured location in which events that occur within such area would be reasonably expected to have an impact on an Insured or the Insured's Business*". The court found that objectively that should be construed as meaning the whole of England and Wales. They drew support for that view because the policy in question provided that SARs was a notifiable disease under the policy and as such it would have been in reasonable contemplation of the parties that a "*SARS-like disease anywhere in the UK would have "an impact" on an insured, or (depending in part on what that business was), its business*".

## Causation - "Following"

The court also considered the meaning of the word "*following*" in a policy from a causation perspective. The insurers had tried to argue that the use of the word "*following*" required the insureds to show that the occurrence of COVID-19 itself was the cause of the business interruption or interference. The court found that the FCA was correct to say that the use of the word "*following*" meant that there needed to be a causal connection between the business interruption and the occurrence of COVID-19 but that it was not the causation contended for by insurers. The court said that this was supported by the wording of the extension because the matters referred to in the extensions themselves "*would not of themselves directly cause interruption to or interference with the* business" but rather "*would in almost every case have such an effect only via the reaction of the authorities and/or of the* public".

## Overall

Essentially and in very broad terms, the result was that the court considered the policies provided cover for any business interruption which the insured could show resulted from COVID-19 provided that there had been an occurrence of it in the applicable area. This included by reason of the actions, measures and advice of the UK

Government, and the reaction of the public in response to the disease from the date when the disease occurred within the applicable area as defined in the policies.

### Two QBE Policies - A Contrasting Position

In relation to two of the QBE policies the court reached a different conclusion. Some key points are as follows:

a. Contrary to the other policies, the extension of cover was in respect of "*events*" of "*an occurrence of a notifiable disease within a radius of 25 miles of the premises*". The word "*event*" has a very specific meaning. The court found that the use of that word meant "*what is being insured is matters occurring at a particular time, in a particular place and in a particular way*". This was the meaning given to "*event*" by Lord Mustill in ***Axa Reinsurance v Field [1996] 1 WLR 1026 at 1035*** and, as explained above, the court considered one of the principles of construction was to give words in a policy their meaning as had been decided in previous cases. The court, therefore, found that the policy was triggered "*on the particular occurrences of the disease within the 25 mile radius*" and "***not** on the fact that the disease had [generally] occurred within the 25 miles*".

b. As such, the court found on the particular policies there is cover **only** if there is business interruption as a result of the "*event*" of the specific person sustaining illness within the area. This starkly contrasts with the wider cover found to be provided by the other policies referred to above, which is that there is cover for the consequences of the UK Government actions that were a response to the pandemic provided a person within the relevant area had sustained COVID-19.

c. The court's view was that their conclusion as regards the extent of cover provided by these policies essentially answered the issue of causation. They held that "*the insured would only be able to recover if they could show that the case(s) within the radius, as opposed to any elsewhere, were the cause of the business interruption.*"

## Prevention of Access & Similar Wordings

The court considered the wordings of Arch, Ecclesiastical, Hiscox, MS Amlin, RSA and Zurich. All of the wordings were different. Some were narrow and others were wide. The court considered all of the different wordings in detail. There were some common and key themes arising. So rather than dealing with the individual arguments advanced in relation to each wording and the court's view, we set out below some comments as regards the court's findings in respect of the common and key themes.

In very broad terms, the policies provided cover for business interruption losses where there had been a "*prevention*" of access to or "*hinderance*" of use of the premises as a consequence of UK Government or local authority "*action*" or "*advice*". Some policies sought to provide there was cover provided the business interruption was a consequence of an "*incident*" within a specified area.

### "Interruption"

The court explained that "*interruption*" was to be given its usual meaning. It did not mean a "*complete cessation*" of the business. It entailed a "*fundamental change*" from the business being insured. In relation to businesses which were either allowed to remain open, such as essential shops or about which the 21 March 2020 regulations were silent, such as professional services businesses, there had not been any business interruption as a consequence of denial or hinderance of access because of those regulations.

### "Action" & "Advice"

Certain policies required the business interruption to be a consequence of "*action*" or "*advice*" of the UK Government or local authorities etcetera. The court found that "*action*" of, say, the UK Government "*where access will be prevented*" requires steps taken by the UK Government to "*have the force of law, since it is only something which has the force of law which will prevent access*". The court explained that the direction of the UK Government on 16 March 2020 for people to stay at home and the days that followed was strongly worded, but did not have the force of law (i.e. there was no legislation mandating people to comply) and was "*advice*". Conversely, by way of illustration, they said that the passing of the 21 March 2020 regulations requiring certain businesses to close could amount to "*action*" because it had the force of law.

### “Prevention” & “Hinderance”

A number of the policies required “*prevention*” or “*hinderance*” of the use of the business premises. The court found that the terms had different meanings as the Court of Appeal had explained in ***Westfalische Central-Genossenschaft GmbH v Seabright Chemicals Limited (unreported)***. They stated, “*the touchstone of prevention is impossibility, whereas hindrance connotes that access is rendered particularly difficult*”. They explained that “*in the case of a business which remained open or was not required to close, that was a hindrance in use, not a prevention of access*”. The court analysed the situation of a local restaurant which in addition to in-restaurant dining offered a takeaway collection or delivery service which may have formed a substantial part of its business. They explained the 26 March 2020 regulations did not require a restaurant to close its premises to the extent the restaurant was providing a takeaway service. The court explained that in such a case there would not be a “*prevention*” of access but a “*hindrance*”. As such, the extent to which there would be cover would depend on whether the policy required a “*prevention*” of or “*hinderance*” to access.

### Locality – “Incident” & “Vicinity”

Certain policies provided cover in respect of business interruption arising from an “*incident occurring*” and some with a specified radius of the insured premises. The court found that the word “*incident*” of itself should be given the same meaning as the word “*event*” which, as mentioned earlier, was something which “*happens at a particular time, at a particular place, in a particular way*” such that the insurance was intended to cover incidents occurring locally with examples of a “*bomb scare or a gas leak or a traffic accident*” being given. The court found that the pandemic was “*too geographically dispersed, variegated, prolonged and non-specific to amount to an incident*”. The court further found that where policies went further and required an “*incident occurring*” within a specified radius that further cemented the position.

Other policies required business interruption “*following a danger or disturbance in the vicinity of the premises*”. The court found that these words provided that the cover afforded was a “*narrow, localised form of cover*”. They said that the undefined term “*vicinity*” has a “*local connotation of the neighbourhood of the premises*”. This can be contrasted with their view that, as explained above, a defined term of “*Vicinity*” in an RSA policy as *“an area surrounding or adjacent to an Insured location in which events that occur within such area would be reasonably expected to have an impact on an Insured or the Insured’s Business*”, should be construed as meaning the whole of England and Wales.

### Overall

Overall, given the wide range of policy wordings, the extent to which there is cover or not for insureds will depend on the precise terms of the policy and the application of those terms to the particular situation of the insureds.

## Hybrid Clauses

The court also considered what they described as “*hybrid*” policies for ease of reference. These were policies where the terms referred to business interruption arising from restrictions imposed on business premises and the occurrence of notifiable disease itself. For the purpose of this note it is sufficient to say that similar considerations apply as explained in the sections entitled “*Notifiable Disease Wording*” and “*Prevention of Access & Similar Wordings*” set out above.

## Trends Clauses

Broadly speaking, a “*trends clause*” is one where insurers seek to limit their liability to any loss which would have been sustained had the insured peril not occurred. In very broad terms, insurers had sought to argue that the insured peril should be very narrowly construed. They argued that it was the occurrence of COVID-19 only which should be treated as the insured peril and not the wider effects of the pandemic including the UK Government’s response to that. If that was correct, then the sums payable to the insured where there was cover could be extremely limited / negligible because the interruption would be calculated on an assumption that the UK Government’s response to the pandemic should be treated as always occurring. In broad terms, the court disagreed in relation to various policies.

The court's comments in respect of an RSA policy provides a good illustration of its view. The court found that the exercise "*must give effect to the insurance effected*" by "*assuming the insured peril did not occur*". The court found that the insured peril was a "*composite one, involving three interconnected elements: (i) inability to use the insured premises (ii) due to restrictions imposed by public authority (iii) "following" an occurrence of infectious or contagious disease*". The court explained that what the policy was covering was a situation where all of those elements are present. Therefore, they found that in answer to the question what would have been the position of the insured's business but for the insured peril, it was necessary to strip out all three interconnected elements which included the national outbreak of COVID-19 (contrary to insurers position that you only strip out the occurrence of COVID-19).

## Prevalence

As explained above, certain policies require proof of the occurrence of COVID-19 within specified geographical locations. The court did not make findings of fact as regard where COVID-19 had occurred. However, insurers did make certain concessions based on the prevalence of COVID-19 based on various things including NHS data. It is expected the issue of the prevalence of the disease will not be a hotly contested issue in the future.

## The Orient Express Case

Insurers placed significant reliance on the ***Orient Express*** case which they argued supported their position that "*but for*" causation was required. The court found that it was distinguishable from the current case as it was concerned with different insured perils and it did not impact upon the wording of the policies the court was considering in this case. However, they considered the case nonetheless and, as such, we consider it is worth a considering this case briefly.

The ***Orient Express*** case concerned a hotel in New Orleans. The owners of the hotel made a claim for material damage and business interruption loss after it was significantly damaged as a consequence of two hurricanes. The hotel was closed for a number of months and suffered very significant business interruption losses. In that case the court found that the insured peril was "*the damage*" to the hotel itself and "*not the cause of the damage*" being the hurricanes. The court found that excluding the damage to the hotel (which it considered to be the insured peril) the business would nonetheless still have suffered very significant business interruption losses. The logic was the surrounding area would have been damaged by the hurricanes such that an undamaged hotel in the position of the insured hotel would still have suffered very significant business interruption.

The court in this case considered there were "*several problems with the reasoning in Orient Express*". The main issue was that there had been a "*misdirection of the insured peril*" and that the "*hurricanes as cause of the Damage were an integral part of the insured peril, not separate from it*". The court explained it considered the judge had erred in ***Orient Express*** by focussing on "*but for*" causation instead of asking what the proximate cause of the loss claimed was. The court explained that the proximate cause "*is not the cause nearest in time to the loss but the "efficient" or "dominant cause"*" and stated if that had been applied a different decision in relation to causation would have been reached. The court's view of the ***Orient Express*** case was that it "*was wrongly decided*".

**Dated: 17 September 2020**

### Further Information

Given the generality of the note it should not be treated as specific advice in relation to a particular matter as other considerations may apply.

Therefore, no liability is accepted for reliance on this note.
If specific advice is required, please contact one of the Partners at Caytons who will be happy to help.

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Changing Perceptions

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