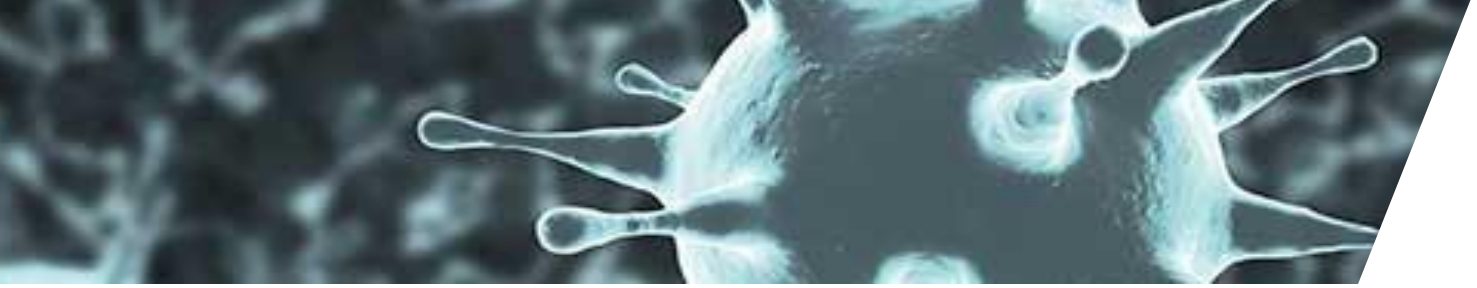

Supreme Court Decision in the FCA's Business Interruption Insurance Test Case

Caytons
Changing Perceptions

Introduction

On 15 September 2020, the High Court handed down its much-anticipated judgment in the FCA's business interruption test case which ran to 162 pages. It found that certain policies provided cover to policyholders whereas others did not. In November 2020, the Supreme Court heard the appeal. On 15 January 2021, the Supreme Court handed down its judgment which ran to 114 pages. The Supreme Court dismissed the insurers' appeal but come to that decision via a fundamentally different analysis in relation to what constituted the insured peril and on causation in a number of instances. Therefore, we have prepared this note on some of the key issues further to our previous note on the High Court decision.

The Facts

Before dealing with the legal issues, it is worth reminding ourselves of the key facts, which 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. Subsequently, on 12 January 2020, the WHO announced that a novel coronavirus had been identified in samples obtained in China. Then 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 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. Following that on 23 March 2020, the UK Government announced lock-down including the closure of further businesses.

Principles of Construction – Objective Intention

The High Court dealt with applicable principles of construction at some length and they were reviewed in our note on that the decision. The Supreme Court did not deal with the principles of construction at length. However, they explained:

"***The core principle is that an insurance policy, like any other contract, must be interpreted objectively by asking what a reasonable person, with all the background knowledge which would reasonably have been available to the parties when they entered into the contract, would have understood the language of the contract to mean. Evidence about what the parties subjectively intended or understood the contract to mean is not relevant to the court's task.***"

Disease Wordings

The Nature of the Cover

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 the policies were written in different terms the court explained that:

"***The general nature of these clauses is that they provide insurance cover for business interruption loss caused by occurrence of a notifiable disease at or within a specified distance of the policyholder's business premisses.***"

The Insured Peril – A Distinction between Disease & Illness

Certain policies required an "*occurrence of [COVID-19] within [an applicable radius]… of the Premises*". Other policies essentially provided the same save that they required an *"event"* of an *occurrence of [COVID-19] within [and applicable radius]… of the Premises*".

The High Court's Decision

As explained in our note on the High Court's decision, the High Court had come to different decisions as regards what the trigger for cover was. The critical distinction was the use of the word *"event"* in the disease wordings.

Non "Event" Wordings: Where policies provided cover for business interruption due to an "*occurrence of [COVID-19] with [the applicable radius]*" the High Court had interpreted the insured peril as business interruption due to "*[COVID-19] of which there is any occurrence within [the applicable radius of] the Premises*". That meant provided there had been an *"occurrence"* of COVID-19 in the applicable area the policy would provide cover for interruption arising from the pandemic and the Government's response to it as a whole. In other words, the interruption suffered by the business did not have to arise from the "*occurrence"* of COVID-19 within the applicable area itself.

"Event" Wordings: However, where policies required "*events*" of "*an occurrence of a notifiable disease within [the applicable radius of] the premises*". The High Court had found that the word "*event*" had a very specific meaning being something which happens "*at a particular time, in a particular place and in a particular way"* per Lord Mustill in ***Axa Reinsurance v Field [1996] 1 WLR 1026 at 1035.*** The High 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*". As such, in the High Court's view there would only be cover if it could be shown "*that the case(s) within the radius, as opposed to anywhere, were the cause of the business interruption*".

The Supreme Court's Decision

As explained above, the Supreme Court explained that the core principle of construction was to interpret the policies objectively by asking what a reasonable person would understand the language used to mean. This principle was of fundamental importance in the Supreme Court's analysis. The Supreme Court disagreed with the High Court as regards the policies which did not use the word *"event".*

The Supreme Court held that "*No reasonable reader of the policy would understand the words "any occurrence of a Notifiable Disease* ***within*** *[the radius]…" to include any occurrence of a Notifiable Disease* ***outside*** *[the radius]*" (as had been the High Court's view).

Critically, the Supreme Court held that the word "*occurrence"* was a synonym of "*event*" which, as explained above, had a very specific meaning being something which happens "*at a particular time, in a particular place and in a particular way"* per Lord Mustill in ***Axa Reinsurance***. They said that a disease "*that spreads is not something that occurs at a*

particular time and place and in a particular way: it occurs at a multiplicity of different times and places and may occur in different ways involving different symptoms of greater or less severity". They explained that:

***"The interpretation which makes best sense of the clause, in our view, is to regard each case of illness sustained by an individual as a separate occurrence"* (emphasis added)**

The Supreme Court made clear that for all policies "*it is only an occurrence within the specified area that is an insured peril and not anything that occurs outside that area*". Accordingly, the policies only covered the relevant effects of cases of COVID-19 that occur at or within a specified radius of the insured premises. They did not cover the effects of COVID-19 that occur outside the applicable radius. The next issue would be how causation would operate in the light of this, which we deal with below.

Prevention of Access & Similar Wordings

Wordings of Arch, Hiscox, and RSA were considered. All of the wordings were different but structured in a similar way.

The Nature of the Cover

Insofar as is relevant to the points on appeal, in very broad terms the policies provided cover for business interruption due to a prevention of access (or similar expression) due to restrictions imposed by an appropriate authority.

The Meaning of "Interruption"

One insurer had sought to argue that "*interruption*" required a cessation of the business. However, the Supreme Court rejected that (agreeing with the High Court) stating that "*interruption*" is "*quite capable of encompassing interference or disruption which does not bring about a complete cessation of business or activities, and which may even be slight (although it will only be relevant if it has a material effect on the financial performance of the business)*".

The Force of Law Point

The High Court's Decision

The High Court had found that *"restrictions imposed"* required the restrictions to have the force of law because the words "*most naturally refers to the legally binding powers that can be exercised in relation to those situations*". The FCA appealed on this point.

The Supreme Court's Decision

The Supreme Court agreed that the ordinary meaning of *"restrictions imposed"* by a public authority would mean measures imposed pursuant to statutory or other legal powers. However, they did **not** think that the restriction always had to have the force of law before it fell within this description. They explained that it was not uncommon for a mandatory instruction to be given by a public authority in anticipation that *"legally binding measures*" would follow shortly afterwards or would do if compliance was not obtained. The Supreme Court considered such a mandatory instruction would be sufficient. Accordingly, they considered the Prime Minister's statement on 20 March 2020 instructing businesses to close, whilst at that point not having the force of law, amounted to a "*restriction imposed*". The Supreme Court considered that is the interpretation a reasonable person would favour. The Supreme Court found this analysis would apply to wordings using terms such as "*closure or restriction placed on the Premises"* and "*enforced closure of an Insured Location*".

Inability to use the Premises

Certain policies required the restrictions imposed to result in an "*inability to use*" the business premises.

The High Court's Decision

The High Court had found that the words "*inability to use*" meant a complete inability to use the whole premises save for use that was de minimis.

The Supreme Court's Decision

The Supreme Court held that an "*inability to use*" had to be established and that an "*impairment or hinderance*" in use was not sufficient. However, they found that there could be an "*inability to use*" a discrete part of the premises for any business purpose. They said that a department store which had to close all parts of the store except its pharmacy would potentially be a case of inability to use a discrete part of its business premises. So the court found there could be an "*inability to use*" the whole or a discrete part of the premises for business activities.

Prevention of Access

A number of policies required a "*prevention of access*" to the business premises.

The High Court's Decision

The High Court had found that anything short of complete closure would not amount to a "*prevention of access*". They had given the example of a restaurant which in addition to in-restaurant dinning offered a takeaway or delivery service. The 26 March Regulations prohibited in-restaurant dinning but permitted restaurants to stay open to provide a takeaway or delivery service. The High Court explained that a restaurant which stayed open to offer takeaway or delivery services would not have suffered a "*prevention of access*" whereas a restaurant that could only offer in-restaurant dinning had.

The Supreme Court's Decision

The Supreme Court viewed maters differently to the High Court. Taking the High Court's example of a restaurant that offered in-restaurant dinning and a takeaway and/or delivery service they found that the more realistic view was that there had been a prevention of access to "*a discrete part of the premises, namely the dinning area of the restaurant, and prevention of access to… the premises for the discrete business activity of providing a dinning in service*". Accordingly, "*prevention of access*" could include prevention of access to a discrete part of the premises or the whole of the premises.

Causation

Principles of Causation

Proximate Cause

The policies provided for a variety of language as regards what causal connection was required between the insured peril and the loss in respect of which indemnity was provided. They included terms such as "*following*", "*arising from*", and "*in consequence of*" to name a few. The Supreme Court explained that they did not think it was "*profitable to search for shades of semantic difference between these different phrases*". Rather, the issue was what "*is the legal effect of the insurance contract, as applied to a particular factual situation*".

Section 55(1) of the Marine Insurance Act 1996 states that:

"…. unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against."

The Supreme Court referred to the need to look at the policy as a whole to ascertain what the parties meant as to the issue of causation by applying "*common-sense*" principles. However, they explained that:

"It is not a matter of choosing a cause as proximate on the basis of an unguided gut feeling. The starting point for the inquiry is to identify, by interpreting the policy and considering the evidence, whether a peril covered by the policy had any causal involvement in the loss and, if so, whether a peril excluded or excepted from the scope of the cover also had such involvement. The question whether the occurrence of such a peril was in either case the proximate (of "efficient") cause of the loss involves making a judgment as to whether it made the loss inevitable….."

Concurrent Causes

Concurrent causes arise together to cause the loss.

Where an insured peril has occurred concurrently with another cause, which is not covered, but critically **not** excluded the courts have found the loss was proximately caused by a peril insured against and, therefore, covered. The Supreme Court referred to an example of this in the ***JJ Lloyd Instruments Ltd v Northern Star Insurance Co Ltd (1987) 1 Lloyd's Rep 32.***

However, in contrast, where a loss arises due an insured peril and a cause which is expressly excluded from cover under the policy, generally the exclusion will prevail and there will not be cover for the loss under the policy.

Turning to the present matter, the insured peril was each individual case of illness. The Supreme Court explained it was clear that each case of illness on its own did not cause the Government to take the action which it did which directly led to the business interruption. However, the measures implemented by the Government were taken in response to all cases of COVID-19 in the whole country. Accordingly, the Supreme Court agreed with the High Court that:

"…. all the cases were equal causes of the imposition of national measures….."

The "but for" Test

The insurers central argument on causation was that the occurrence of the insured peril made no difference to the occurrence of loss. In other words, they said but for the insured peril the business interruption would always have occurred. To elaborate, in the disease wordings, their position was essentially that but for specific occurrences of COVID-19/illness within an appliable radius the national measures imposed by the Government would always have been imposed and thus the business interruption would always have occurred. If that argument had succeeded, then the reality is the policies would not have responded because there would still have been national measures in place even if an area of say 25 miles from a business premises was COVID free. The insurers relied heavily on the ***Orient Express*** case to which we refer below. For present cases, the Supreme Court described the but for test as "*inadequate*".

Multiple Concurrent Causes

This was a case where the Supreme Court had said the insured peril was each individual case of illness. In other words, a situation where there were multiple concurrent causes arising to result in the national measures imposed by the Government. They explained that whether an event which is one of very many that combine to cause loss

should be regarded as a cause of loss is not one to which a general answer can be given, and it must always depend on the context in which the question is asked. They went on to say:

"…. there is nothing in principle or in the concept of causation which precludes an insured peril that in combination with many other similar uninsured events brings about a loss with a sufficient degree of inevitability from being regarded as a cause – indeed as a proximate cause – of the loss, even if the occurrence of the insured peril is neither necessary nor sufficient to bring about the loss by itself…."
In other words, individual cases of illness within an applicable radius (the insured peril) could be a proximate cause of loss when combined with occurrences of cases of illness outside of the radius (which were not an insured peril but importantly **not** excluded from cover).

Causation - The Disease Clauses

The FCA's Position

The FCA's position was that causation would be satisfied if each individual illness from COVID-19 was an equally effective cause of the Government measures and consequent business interruption i.e. the multiple concurrent causes approach.

The Insurers' Position

The Insurers' position was that "*but for*" causation should be applied or, alternatively, that a single case of disease or a relatively small number of cases within the radius had to satisfy the causal connection required by the policy.

The Supreme Court's Decision

The Supreme Court considered the background was critical in interpreting what the policy wording required from a causation perspective. In terms of a new infectious disease such as SARS no reasonable person would suppose that if an outbreak occurred within the radius provided by the policy and was sufficiently serious to interrupt the insured's business, all the cases would occur within the radius.

Accordingly, Supreme Court agreed with the FCA's position the parties could not reasonably be supposed to have intended that cases of disease outside the radius could be set up as a countervailing cause which displaces the causal impact of the disease inside the radius. They rejected the insurers' submissions on *"but for"* causation and their alternative position that it was only the cases within the radius that should count for the purpose of causation.

The Supreme Court summarised the position by stating:

"On the interpretation that we think makes best sense, only the effects of any case occurring within the radius are covered but those effects include the effects on the business of restrictions imposed in response to multiple cases of disease any one or more of which occurs within the radius"

Causation - The Prevention of Access & Hybrid Clauses

These clauses were different to the disease clauses from a causation perspective because they would specify a number of conditions that needed to be satisfied from a causation perspective. For instance, one of the polices provided cover for loss arising from a variety of different causes as follows:

"***resulting solely and directly*** *from an interruption to your activities* ***caused by****… your inability to use the insured premises* ***due to*** *restrictions imposed by a public authority during the period of insurance* ***following****…. an occurrence of any human infectious or human contagious disease….."*

The Supreme Court explained that the policy would respond if **all** of the elements of the insured peril acted in causal combination to cause the business interruption loss. That was still the case if other causes (provided they were not excluded) contributed to the business interruption loss.

However, the Supreme Court explained that their interpretation depends on a finding of concurrent causation involving causes of "*approximately equal efficacy*". They explained that if all of the elements were present, but they could not be regarded as the proximate cause of the loss, and the reality was that the COVID-19 pandemic itself was the sole proximate cause of the loss the policy would **not** respond. The court gave an example of a travel agency which lost all of its business due to the travel restrictions imposed by the pandemic. They said whilst it was true that access to premises might have become impossible, if it was found that the sole proximate cause of the loss of its walk-in customer business was the travel restriction (not the inability to use the premises) then the loss would **not** be covered.

Trends Clauses

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. The insurers had sought to argue that the losses should be adjusted on the basis that if the insured peril had not occurred the wider effects of the COVID-19 pandemic would have done such that the loss indemnified was minimal.

The Supreme Court disagreed. They considered that the trends clauses should be interpreted so that the standard turnover or gross profit derived from previous trading is adjusted **only** to reflect circumstances which are unconnected with both the insured peril (individual cases of illness) and matters which are "*inextricably linked*" with the insured peril i.e. such as the Government response to the pandemic.

The Orient Express Case

Insurers placed significant reliance on the ***Orient Express*** case. That 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 applied "but for" causation and 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 Supreme Court explained that the case had been wrongly decided. They explained that the "but for" test was not the correct test to apply. They said the correct analysis was that the damage to the hotel (an insured peril) and damage to the surrounding area (not an insured peril but **not** excluded from cover under the policy) operated concurrently to give rise to the business interruption. Accordingly, the correct position was the business interruption was proximately caused by an insured peril such that the policy should have been found to respond.

Overall

Overall, it is the insureds who "*will be drinking the champagne*". The decision demonstrates the extremely technical nature of policy coverage matters and the importance of the precise language used.

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Further Information

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