Supreme Court Judgment in FCA Business Interruption Test Case: a lifeline for SMEs

By James Palmer and Reanne MacKenzie

The Supreme Court has handed down judgment in the FCA Business Interruption Test Case. In a main judgment by Lord Hamblen and Lord Leggatt with which Lord Reed (President) agreed, and a separate concurring judgment by Lord Briggs, with which Lord Hodge (Deputy President) agreed, the Supreme Court dismissed the Insurers' appeals and substantially allowed the FCA's appeal. This is the final word on the meaning of various business interruption clauses and will come as a relief to policyholders as the insurance industry should now pay out on Coronavirus claims, worth over an estimated £1.8 billion.

Introduction

1. In light of the Coronavirus Pandemic and resulting public health measures, thousands of claims have been made under various insurance policies that include cover for business interruption losses arising from a number of different causes. Across the industry, insurers have declined to pay out on the ground that the policies do not cover the effects (or certain effects) of the COVID-19 Pandemic.

2. As a matter of urgency the Financial Conduct Authority ("FCA") brought proceedings under the Financial Markets Test Case Scheme. The FCA brought the case for the benefit of policyholders, the majority of which are small and medium enterprises ("SMEs"). The defendants are eight insurance companies. The aim of the proceedings, as set out in the Framework Agreement signed by the parties 1 June 2020, was to achieve the maximum clarity possible for the maximum number of policyholders and insurers, consistent with the need for expedition and proportionality.

3. An eight day remote trial took place between 20 and 30 July 2020, heard by

Flaux LJ and Butcher J. The first instance decision was handed down on 15 September 2020. Permission to appeal was granted and the appeals were certified as suitable for the "leapfrog" procedure and were appealed directly to the Supreme Court, bypassing the Court of Appeal. The appeal took place by remote hearing over four days from 16 to 19 November 2020.

The Issues on Appeal

4. The Supreme Court addressed the following issues on appeal:

   i. the interpretation of "disease clauses" (which cover business interruption losses resulting from any occurrence of a notifiable disease within a specified distance of insured premises);

   ii. the interpretation of "prevention of access" clauses (which cover business interruption losses resulting from public authority intervention preventing access to, or the use of, business premises) and "hybrid clauses" (which contain both disease and prevention of access elements);

   iii. the question of what causal link must be shown between business interruption losses and the occurrence of a notifiable disease (or other insured peril specified in the relevant policy wording);

   iv. the effect of "trends clauses" (which prescribe a standard method of quantifying business interruption losses by comparing the performance of a business to an earlier period of trading);

   v. the significance in quantifying business interruption losses of effects of the pandemic on the business which occurred before the cover was triggered ("Pre-Trigger Losses"); and

   vi. in relation to causation and the interpretation of trends clauses, the status of the decision of the Commercial Court in *Orient-Express Hotels Ltd v*

Assicurazioni Generali SpA (trading as Generali Global Risk) [2010] EWHC 1186 (Comm) ("Orient-Express").

(i) Disease clauses

5. The Court interpreted the disease clauses as providing cover for business interruption losses resulting from COVID-19 (which was made a notifiable disease on 5 March 2020) provided there had been an occurrence (meaning at least onecase) of the disease within the geographical radius.

6. The Court rejected the argument made by certain insurers that the disease clause did not provide any cover at all for business interruption resulting from COVID-19 because any loss caused by an occurrence of a notifiable disease was excluded from cover if the disease amounted to an epidemic, by way of the general exclusion clause that included "epidemic and disease." The Court held at [78]: " *The reasonable reader would naturally assume that, if the intention had been to put a further substantive limit on the risk of business interruption specifically insured by the extension for infectious diseases in addition to the geographical and temporal limits stated in the extension itself, this would have been done transparently as part of the wording of the extension and not buried away in the middle of a general exclusion of contamination and pollution risks at the back of the policy."*

(ii) Prevention of Access and Hybrid Clauses

7. Prevention of access and hybrid clauses typically specify a series of requirements which must all be met before the insurer is liable to pay. Some clauses apply only where there are "restrictions imposed" by a public authority following an occurrence of a notifiable disease. The Court rejected the finding below that such restrictions had to have the force of law, but held that such restrictions may include an instruction given by a public authority that carries the imminent threat of legal compulsion or is in mandatory and clear terms and indicates that compliance is required without recourse to legal powers. The Court did not rule on individual measures, but indicated that the

argument is stronger in relation to some general measures (defined at [109]) such as certain instructions in mandatory terms from the Prime Minister.

8. The Hiscox wordings provided cover only where business interruption loss is caused by the policyholder's "inability to use" the insured premises. The Court held that this means complete (not partial) inability to use the premises. The Court agreed that inability rather than hindrance of use must be established, but held that this requirement 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.

(iii) Causation

9. A key question in relation to the disease clauses is whether business interruption losses consequent on public health measures taken in response to COVID-19 were, in law, caused by cases of the disease that occurred within the specified radius of the insured premises. The Court found that the relevant measures were taken in response to information about all the cases of COVID-19 in the country as a whole. The Court found that all the individual cases of COVID-19 that 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 is therefore 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 geographical area covered by the clause.

10. The Court emphasised and recognised that the "but for" test is, in some situations (such as the present one) inadequate, particularly where a series of events all cause a result although none of them is individually either necessary or sufficient to cause the result by itself.

11. In relation to the prevention of access and hybrid clauses, the Supreme Court held that business interruption 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 caused by other (uninsured) effects of the COVID-19 Pandemic does not exclude them from cover under such clauses.

(iv) Trends clauses

12. Trends clauses are common to the quantification of business interruption losses and operate by comparing previous financial data with prevailing circumstances at the date of incidence of any insured perils. For example, an actual or anticipated strike or declining economic activity generally or in a specific region or sector might be taken into consideration in attempting to calculate a policyholders true losses in accordance with the indemnity principle.

13. The argument which the Insurers sought to advance was that the wider impact of the COVID-19 Pandemic was itself a factor which should be taken into account by insurers in calculation of losses. The Supreme Court distinguished these as being a part of the machinery of the policy for quantifying loss and that construing them consistently should not lead to those clauses to removing cover, as to do so would transform a quantification procedure into a form of exclusion.

14. Having reviewed a number of textbooks dealing with the law of business interruption and considering US case law, the Court concluded that on their proper construction, the clauses should only reflect circumstances (at [287]:

> *'which are unconnected with the insured peril and not circumstances which are inextricably linked with the insured peril in the sense that they have the same underlying or originating cause. Such an approach ensures that the trends clause is construed consistently with the insuring clause, and not so as to take away cover prima facie provided by that clause.'*

The Supreme Court therefore concluded that losses should not be adjusted to reflect other consequences of the COVID-19 Pandemic. To the authors of this Alerter, that does not seem to be a surprising conclusion.

(v) Pre-trigger losses

15. The first instance decision permitted some adjustments to be made in respect of any measurable downturn in business attributable to the COVID-19 Pandemic which preceded the trigger of an insured peril. The FCA appealed this aspect of the first instance judgment.

16. On the basis of its interpretation that the aim of trend clauses does not include circumstances caused by the insured peril, and the aim of any adjustment was to represent the results which would have been achieved had the insured peril not occurred, the Supreme Court regarded events which were being felt before cover was triggered made no difference (at [295]:

> '*…to reduce the indemnity to reflect a downturn caused by other effects of the pandemic, whenever they began, would be to refuse to indemnify the policyholder for the loss proximately caused by the insured peril…*' (emphasis added)

(vi) Status of Orient-Express

17. In their joint judgment Lords Hamblen and Leggatt dealt with the judgment in the *Orient Express*[1] case, in which George Leggatt Q.C (as he then was) had sat as arbitrator and Hamblen J (as he then was) had given judgment on an appeal to the Commercial Court. Whilst leave had been given to appeal the matter to the Court of Appeal (unusually under the Arbitration Act) the matter settled before the appeal was

[1] *Orient-Express Hotels Ltd v Assicurazioni Generali SpA (trading as Generali Global Risk)* [2010] EWHC 1186 (Comm)

heard and the issue resolved. Together they invoked the words of Justice Jackson sitting in the US Supreme Court in 1950, who said:

> *'If there are other ways of gracefully and good naturedly surrendering former views to a better considered position, I invoke them all.'*

18. In view of their conclusions on the trends clause, they reached the conclusion that the *Orient Express* case was wrongly decided and should be overruled, with the effect that the insurers arguments on causation of loss based on the *Orient Express* decision failed. In the circumstances the writers feel that the readers may be spared a detailed exposition of the arguments and findings of that case.

Conclusion

19. This will be a welcome result to the thousands of SMEs whose businesses have been decimated by the Coronavirus Pandemic and subsequent public health measures taken in response.

20. This case demonstrates the utility and effectiveness of the FCA Test Case Scheme: these important legal issues have been finally determined in a little over 7 months, saving both parties the considerable time and cost of having to deal with thousands of individual claims or protracted Group Litigation.

21. This case is also a testament to the resilience and effectiveness of the English legal system, even during a global pandemic: the "leapfrog" appeal took place by remote hearing (something unthinkable this time last year) in November 2016 and the Supreme Court handed down judgment within two months (including the Christmas period). This prompt determination should now mean thousands of policyholders are paid out on their insurance policies, providing a vital lifeline to many businesses.

22. Finally, this case provides the first (and perhaps final) Supreme Court exposition on the key chronology of how the Coronavirus Pandemic and Government measures

unfolded in the early part of 2020. Any party wishing to bring a claim related to the Coronavirus Pandemic could do worse than start with paragraphs [7] to [35] of the Supreme Court's judgment.

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