UK Test Case on Business Interruption Coverage

Thomas Macmillan
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The volume of claims being made by companies worldwide for business interruption coverage in the wake of Covid-19 shutdowns has been unprecedented. As of August 2020, the rate of Canadian companies seeking creditor protection has been quadruple the normal pace. With Covid-19 cases currently on the rise after a relatively quiet summer, and with more restrictions anticipated, it can be expected that this number will balloon further.

Insurers have been inundated with claims, and with it has come intense scrutiny of common wording in business interruption clauses in all risks policies. David Rogers of our office previously provided an excellent summary of the issues facing insureds when it comes to such claims.

As it currently stands, insurers are still denying most claims on the basis that, absent specific endorsements for communicable diseases and closure by order of civil authority, coverage for business interruption requires physical damage to a business. There is no such physical damage in cases of Covid-19 outbreaks.

The UK Financial Conduct Authority, an organization that speaks on behalf of consumers in the financial system, anticipated that widespread litigation could result from coverage denials relating to business interruption claims, and this summer brought a test case on key policy wording.

The High Court last week made its ruling in *The Financial Conduct Authority v. Arch and Others,* [2020] EWHC 2448 (Comm). The ruling should provide clarity on how the courts will interpret these provisions.

Eight insurers agreed to act as defendants in the test case, and furthermore agreed in advance to abide by the ultimate ruling when it comes to their processing claims. The parties may appeal the ruling directly to the UK Supreme Court as part of an expedited

process. A post-ruling hearing on October 2, 2020 will provide insight into whether any parties plan to appeal.

While only eight insurers participated in the test case, it can be expected that all other insurers who underwrite such policies are paying close attention to the case. Wording on such policies differs slightly, but is generally similar.

Insurers and insureds can assume that the courts will look to the test case ruling as persuasive authority, and will seek to decide subsequent litigation consistently. As such, the importance of this test case cannot be understated when it comes to the wave of claims that have already washed ashore, and those still on the way.

What Was Decided?

A full account of the decision is not possible in a short summary. The decision itself is over 160 pages of complex analysis of policy wordings. Among the eight insurers, 21 different groups of business interruption policy wordings were considered.

Furthermore, these wordings were analyzed in the context of different hypothetical regulatory environments, contemplating how different businesses would be affected by shutdown orders and restrictions.

That being said, some broad themes emerged that will provide an interpretive framework for insurers and insureds whose policy language differs from the ones reviewed.

Communicable Disease Coverage

The court looked at a number of different wordings relating to business interruption caused by the outbreak of disease in a certain geographical proximity to the insured business. The restriction to a certain vicinity is meant to preclude coverage for diseases that take place nowhere near the business at issue; there must be proximate connection between the disease and the business.

At issue in the test case was the impact of outbreaks of Covid-19 that occurred outside of the geographical limits set out in the policies (for some it was 1 mile of the business, for others 25 miles). Specifically, how are parties to interpret coverage when the government response to a disease is the result, not of the local outbreak near the business, but of more widespread outbreaks elsewhere?

The court ruled in the negative on that question, for most of the policy wordings considered (but not all). It found that the separate outbreaks of Covid-19 are indivisible, and that all of them together trigger coverage, so long as there is in fact infection within

the area outlined in the policy. The court stressed that so long as this latter condition is met, it does not matter whether government response resulted exclusively from that local outbreak.

It is important to remember here, however, that the question of coverage for communicable disease coverage is dependent on the specific wording of the policy. The court in *FCA* looked at a number of slightly different wordings, and came to different conclusions on some of them. Accordingly, it is important to consider the actual wording of the policy at issue, before confirming or denying coverage.

Civil Authority

The court also considered policy wording relating to coverage for business interruption loss caused by closure or restriction by order of a civil authority. The court's conclusions on coverage in this category are very wording-specific, and caution should exercised in this regard. Some policies contemplate, for example, government action arising because of "danger or disturbance in the vicinity."

The court stressed that wording such as this implies a localised emergency response. Insurers and insureds are wise to consider the specific nature of the civil authority restrictions and regulations, in order to determine whether they would trigger coverage in that instance.

The court also drew a distinction between "advice" provided by government, and "action," often with the latter only triggering coverage. Mandatory pronouncements from government are more likely to trigger coverage than are recommendations.

In considering whether a pronouncement is mandatory, as opposed to recommended, only the former requires steps which can be lawfully enforced by the authority requesting it. The court looked at a number of government pronouncements in March of 2020, outlining how some of them amounted merely to recommendations, and others to actions which would trigger coverage.

The court also noted that business interruption coverage might be triggered in circumstances where normal business operations are merely disrupted, but not ceased entirely. Again, however, the precise wording of the policy prevails in interpreting such coverage.

Single Cause

A central issue argued during the case was whether the pandemic itself and the resulting government response constitute a single cause of a business' loss, or whether they are

divisible. This is a key issue, as all business interruption requires that a covered loss be caused by an occurrence.

The High Court found that the pandemic and resulting response amount to a single cause of the covered loss. This is welcome clarity, as it limits the potential for widespread litigation on the issue of whether the cause of insured losses were the pandemic or government restrictions.

The court addressed the 2010 decision in *Orient Express Hotels Ltd. v. Assicurazioni Generali SpA*. In that case, the court sided with an insurer who argued that there were minimal losses to an insured hotel arising from the flooding caused by hurricane Katrina. The court agreed that, while the flood itself damaged the hotel, the fact that flooding devastated the region surrounding the hotel meant that the damage did not cause the business loss: it could be expected that no guests would attend the hotel in any event.

The court in *FCA* found that *Orient Express* was distinguishable on construction of relevant causes, but in any event that it was wrongly decided. The court opined that the decision in *Orient Express* misidentified the peril at issue, that it was not "damage," but more properly "damage caused by hurricanes." Construed this way, the flooding of the vicinity surrounding the hotel was clearly caused by the insured peril.

Furthermore, the court noted that *Orient Express* results in the absurd outcome that the more significant the circumstances that lead to property damage (there, a truly devastating flood), the less coverage would be available to an insured.

This point is important, as the argument was raised that, even if there was an outbreak within the outlined vicinity of the affected business, nevertheless the existence of other outbreaks elsewhere, nationally, was the true cause of the business interruption loss. In other words, business interruption losses in this context resulted not from local outbreaks, but from the widespread nature of the epidemic.

The court rejected this argument, stressing that once coverage is confirmed, through the existence of infection within the outlined vicinity, then it is irrelevant what other outbreaks take place elsewhere. The outbreak and the resulting response, then, are one single cause of the covered loss.

Trends Clauses

The court also considered application of "trends clauses" in the context of the pandemic. Put simply, a trends clause guides assessment of indemnity, by reducing recoverable damages only to those caused directly by the insured peril, rather than by outside factors.

The idea is to put the insured in the place that it would have been in had the damage not occurred.

In the example of a restaurant, strict application of a trends clause could suggest that its loss of business from the disease itself is minimal, as most of its loss can be traced to the regulatory response to the pandemic. In other words, an Ontario restaurant was going to lose business in any event, given provincial restrictions, whether or not there was an outbreak in the vicinity of the restaurant.

The court's treatment of trends clauses in *FCA* mirrored its treatment on the causation question, above. It found that the insured peril is the interruption of business following the occurrence of disease, including via a civil authority's response.

Accordingly, if a restaurant is required to close its doors as a result of a public order, it should be permitted to claim damages arising from that lost business, even though the order resulted from outbreaks elsewhere in the province, and even though the restaurant may have suffered most of its losses anyway had a local outbreak not taken place.

Where Things Stand Now

As noted above, there is a possibility of an expedited appeal of the High Court's ruling. If there is no appeal, however, insurers and insureds the world over are left with some clarity on how the courts will interpret a number of different policy wordings relating to Covid-19-related business interruption losses.

Even insurers who did not participate in the test case can find clarity in some of their own policies, and insureds can get a sense of how the courts will interpret potentially ambiguous policy wording. The FCA appears happy with the outcome, and at present it is unclear whether the insurers will appeal or simply go ahead and settle existing and future claims in line with the ruling.

It perhaps goes without saying that the stakes here are historically high, in light of the volume of business interruption claims that have been and will be made in relation to the pandemic. Stay tuned, as it is safe to assume that this issue is