



The business interruption insurance test case

Nick Pointon, Georgina Thompson and Daniel Soar

Introduction

This short note¹ summarises the key parts of the Supreme Court's decision in this important test case, by which it allowed most of the FCA's appeals against the decision of the Divisional Court and found largely in favour of policyholders.

The key points are:

- The Supreme Court respected the express language used to define the insured peril, rejecting the more expansive construction adopted at first instance.
- But it favoured policyholders by adopting a more flexible approach to causation, eschewing the but-for approach advocated by the insurers and construing quantum mechanisms such as "trends" clauses in a manner which preserved the overall purpose of cover.

Disease clauses

Disease clauses cover business interruption losses resulting from the occurrence of a notifiable disease within a set distance of the insured's premises, usually 25 miles. Two central issues arose:

1. What was the insured peril?
2. What causal relationship between the insured peril and business interruption had to be established?

A central plank of the insurers' case argued that (a) the insured peril was only the occurrence of the virus within the radius, and (b) but-for the cases within the radius, the national restrictions would still have been imposed in response to the many cases elsewhere. Therefore, said the insurers, even if a policyholder can prove cases within the radius, they could never show that *those* cases (and not others) caused the interruption to their business.

The Divisional Court described the insured peril as the COVID-19 pandemic itself. It held that separate cases should be viewed as one indivisible cause, or alternatively as a collection of individual causes, none of which was more potent than any other in inducing the restrictions imposed in response to the pandemic. This approach to construction simultaneously overcame the insurers' argument on causation.

The Supreme Court disagreed, holding that (a) each case of illness had to be treated as a separate "occurrence", and (b) cover only existed for business interruption losses resulting from cases occurring within the radius. This

¹ This note is necessarily a simplification of the lengthy Supreme Court judgment. It is not legal advice and should not be relied upon as such.

result was driven by the express language of the policies. Consequently, the insured peril was not COVID-19 itself, but rather particular cases of illness sustained within the radius (§93).

This left the insurers' causation argument in play. To meet it, Lords Leggatt and Hamblen JJSC exposed some of the weaknesses of but-for causation and refused to apply it here. Instead, it was sufficient to prove that interruption was a result of government action taken in response to cases of disease which included *at least one* case of COVID-19 within the radius. That is what the parties meant by the language of the policy.

Of interest is the role which construction played in determining the approach to causation. It is not a question of a legal wrong causing loss (as in tort, or breach of contract) – causation is used in a different sense, to identify the circumstances in which the contractual obligation of cover arises. Yet unspoken parallels exist between the exercise of construing the causal terms of the policy and the modern role played by assumption of responsibility in testing remoteness of loss for breach of contract. Both lean very heavily upon the presumed meaning of words read against the matrix of admissible facts. Both are, in reality, asking the same question – what loss would the reasonable reader think that the parties intended to cover?

Prevention of access and hybrid clauses

Construction

The Court examined six prevention of access and hybrid clauses found within insurance policies from three different insurer Defendants; Royal & Sun Alliance Insurance Plc, Hiscox Insurance Company Ltd and Arch Insurance (UK) Ltd. There were five hybrid clauses (RSA1 and Hiscox 1-4), and one 'pure' prevention of access clause (Arch).

The approach adopted by the Supreme Court when construing the scope and parameters of these clauses was to break down the wording of each of these six clauses into discrete elements so as to ascertain the meaning of the clause as a whole, and thus whether the indemnity would be triggered (§97).

The various elements examined by the Supreme Court were:

- (i) The 'disease' aspect of the hybrid clauses;
- (ii) The reference to "restrictions imposed" and whether this meant restrictions which were backed by force of law and/or expressed in mandatory terms;
- (iii) The nature of the restrictions imposed in terms of whether a restriction was being imposed on the general public, or merely the policyholder and its premises;
- (iv) The meaning of "inability to use" and the extent to which the policyholder was unable to use its premises;
- (v) The extent to which premises would be required to have closed due to restrictions so as to come within the "prevention of access" provision; and
- (vi) The meaning of "interruption".

It was held that only if all elements were satisfied would the indemnity be triggered such that the insurer would be required to indemnify policyholders in respect of business interruption losses.

As to the extent of restrictions upon use, the Supreme Court departed from the Divisional Court's analysis (which required "*a complete inability to use the premises for the purposes of the business*") and required only that "*the*

policyholder is unable to use the premises for a discrete part of its business activities or [is] unable to use a discrete part of its premises for its business activities.”

As to the force of those restrictions, the Supreme Court again disagreed with the Divisional Court’s approach (which required restrictions to have the force of law in order to trigger cover), holding that mandatory instructions could still satisfy the policy requirements before they acquired the force of law. Yet the Supreme Court left open the question of whether the “general” measures (as opposed to “specific” measures) announced in the Prime Minister’s early speeches would trigger cover in each case, leaving the point for agreement or further argument.

Causal sequencing and concurrent clauses

When considering the question of causation in relation to the hybrid and prevention of access clauses, the Supreme Court examined how the different elements of each clause interacted with each other so as to determine, in principle, what loss would be covered by the clause.

In an interesting turn of events, the Supreme Court disagreed with both the approach taken by the Divisional Court at first instance and the alternative approach proffered by the Defendant Insurers.

The Supreme Court held that, unlike the disease clauses, the prevention of access clauses and hybrid clauses specified more than one condition which must each be satisfied in turn, in order to establish that business interruption loss had been caused by an insured peril. The structure of the clauses meant that the elements of the clause are required to operate in a causal sequence which varied in length from two (RSA1) to four (Hiscox) elements.

Trends clauses

Trends clauses call for an inquiry into what the financial results of the business would have been if the insured peril had not occurred (i.e. but for the insured peril). They allow the policyholder’s projected turnover to be adjusted in order to take into account specific reasons why a higher or lower turnover would be expected during the indemnity period.

The insurers argued that, as the insured peril was the occurrence of COVID-19 within the stipulated radius, the trends clauses could be utilised to calculate loss on the footing that the pandemic raged in all other areas, save for within the radius. Clearly in many cases such an interpretation would result in the policyholder’s estimated turnover being drastically reduced (or extinguished) due to the impact of the national lockdown restrictions.

The Supreme Court rejected this argument on the basis that trends clauses are designed to quantify the policyholder’s loss and are not intended to limit or take away the cover provided by the insuring clauses. Although the application of ‘but for’ causation was required by the words of the trends clauses, the court held that the correct construction which preserved the overall purpose of the cover required an inquiry into the policyholder’s likely performance but for the insured peril *and circumstances arising out of the same underlying or originating cause*. In this instance the underlying and originating cause was the COVID-19 pandemic as a whole (i.e. not just that part falling within the geographical radius).

The result is that the effect of COVID-19 on a policyholder should not be taken into account when assessing what the likely financial performance would have been during the indemnity period.

Pre-trigger losses

One concession that had been made by the Divisional Court to the insurers was the finding that, under the trends clauses, the inquiry should take into account any measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered. Importantly, it was also stated that the downturn could be assumed to continue during the indemnity period.

In addressing this issue, the Supreme Court used the example of a pub which had the benefit of insurance with a prevention of access clause. The pub experienced a 30% downturn in business in the weeks leading up to the 20 March 2020 restrictions, due to the government guidance that had been released by that time. However, the prevention of access clause would not have been triggered until the restrictions were imposed. The Divisional Court's decision meant that the trends clauses would allow the insurers to reduce the pub's estimated turnover during the indemnity period by 30%. This would have meant a significant reduction in the loss covered by the policy in many instances.

The Supreme Court disagreed with this conclusion on the basis that it was inconsistent with the Divisional Court's finding that the insured's loss should be assessed on the assumption that there was no COVID-19 pandemic. If the trends clauses require the circumstances arising out the same underlying or originating cause to be ignored, the effects of COVID-19 must be stripped out, even if they occurred before the insured peril was triggered. Accordingly, it should not be assumed that pre-trigger losses would have continued during the indemnity period when applying the trends clauses (§296).

The Orient-Express case

The Orient-Express case² was heavily relied upon by the insurers. The case concerned the business interruption policy held by a hotel in New Orleans which had suffered damage as a result of Hurricanes Katrina and Rita in 2005. The policy contained a trends clause similar to those in issue. The insurer argued that the insured peril was only the physical damage suffered by the hotel (not the hurricanes themselves) and therefore the trends clause could be used to estimate the hotel's likely performance had the hurricanes still occurred, but where no damage was done to the hotel. On this analysis, the hotel would not have had any customers in the indemnity period because of the devastation of the rest of the city. The arbitral tribunal (which included Mr George Leggatt QC, as he then was) and Hamblen J on appeal agreed with the insurer, holding that the trends clauses required an inquiry into the hotel's estimated performance but for the insured peril.

The Supreme Court (including Leggatt and Hamblen JJSC, as they had by now become) held that the Orient-Express case had been wrongly decided. It held that the correct approach would have been to exclude the hurricanes from the counterfactual scenario in which the damage had not occurred. This was because both the damage to the hotel and the damage to the surrounding area had the *same underlying or originating cause* (i.e. the hurricanes).

Summary

² [Orient-Express Hotels Ltd v Assicurazioni Generali SpA](#) [2010] EWHC 1186 (Comm); [2010] Lloyd's Rep IR 531

This was an important win for policyholders. It is also a welcome decision for the clarity it brings to the process of interpretation and the principles of causation. The Supreme Court's treatment is simultaneously more faithful to the express language drafted by the insurers *and* to the meaning which that language would convey to the reasonable SME, who conscientiously reviews their policy without the assistance of a "pedantic" insurance lawyer. There will undoubtedly be further skirmishes in respect of different policy wording and the detailed approach to quantum in each case, but the insurers are now coming from one-nil down.

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St John's Chambers, Bristol
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