# UK Supreme Court hands down judgment in the FCA's COVID-19 non-damage business interruption insurance test case

INSURANCE HORIZONS

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## Introduction

On Friday 15 January 2021 the UK Supreme Court handed down its important judgment in the FCA's COVID-19 non-damage business interruption insurance test case.

In a ruling that has significant implications for insurers, reinsurers and policyholders alike, the Supreme Court substantially allowed the FCA's appeals (brought on behalf of SME policyholders) and unanimously dismissed insurers' appeals of the High Court's judgment at first instance.

## Executive Summary

The Supreme Court has substantially upheld the FCA's appeals and dismissed insurers' appeals from the High Court judgment. Although insurers were successful on certain discrete issues – such as the proper interpretation of the "disease" clause extensions of cover – and the Supreme Court was critical of the reasoning of the High Court in several respects, none of this affected the overall outcome.

Indeed, because of its decisions on the interpretation of certain "prevention of access" and "hybrid" clauses, the Supreme Court has materially broadened the cover available to policyholders for business interruption loss caused by the effects of the COVID-19 pandemic in the UK compared with the earlier High Court judgment.

The Supreme Court's analysis of issues relating to causation in insurance cases, its rejection of insurers' arguments on the application of standard "trends" clauses in property damage/business interruption policies, and its over-ruling of the insurer-friendly decision in the *Orient Express Hotels* case, all mean that the judgment is likely to have long-lasting implications for the property insurance markets and more widely.

In particular, the Supreme Court held:

- "Disease" clauses are triggered following the occurrence of at least one case of COVID-19 within the area/radius specified in the wording. The causation requirement is "satisfied by showing that one or more cases of illness from COVID-19 had occurred within the specified radius before national restrictions which caused interruption of the insured

business were imposed."

- "Prevention of access" and "hybrid" extensions are triggered by the insured peril, regardless of whether the loss suffered was concurrently caused by other (uninsured but not excluded) consequences of the COVID-19 pandemic. It will continue to be necessary to compare policy wordings carefully against the Supreme Court and High Court judgments to work out whether there is cover in individual cases.
- "Trends" clauses cannot be relied on by insurers to reduce the indemnity because of the concurrent, uninsured effects of COVID-19. Crucially, the only adjustments which can be factored into the indemnity calculation are in respect of trends or circumstances entirely unrelated to COVID-19.
- The 2010 *Orient Express Hotels* case was wrongly decided and was therefore overruled. Accordingly, if an insured's losses were concurrently caused by an insured peril and an uninsured peril, which arose from the same underlying fortuity, loss resulting from both causes operating concurrently is covered. This is perhaps the most far-reaching aspect of the judgment.

## Recap

The case was brought by the FCA as the first Financial Markets Test Case on an expedited basis, including a leapfrog appeal to the Supreme Court, using a procedure which permits appeals in exceptional circumstances to bypass the Court of Appeal. Sample policy wordings were selected and the case proceeded on the basis of agreed facts.

The key question under consideration by the Supreme Court was whether cover was triggered under the policy wordings for business interruption losses due to the COVID-19 pandemic and the response to it, particularly the first national lockdown from March 2020.

In an unprecedented move, the FCA took arguments on behalf of policyholders, and eight insurers participated as defendants.

You can find a link here to our briefing on the High Court's judgment and a link here to our summary of the key issues under appeal in the Supreme Court.

## Issues under appeal

Not every finding of the High Court was appealed. For example, issues of prevalence and proof were not considered. The Supreme Court categorised the issues under appeal as follows:

- "Disease" extensions of cover;
- "Prevention of access" and "hybrid" extensions;
- Causation;
- "Trends" clauses;
- Pre-trigger losses; and
- The 2010 decision in the case of *Orient Express Hotels*.

The Supreme Court's ruling addresses complex issues arising from the COVID-19 pandemic that the property insurance market have been grappling with for the past year. The judgment needs to be reviewed carefully, and read together with the High Court judgment which remains binding on a variety of issues which were not successfully appealed, in order to properly understand how individual policy wordings should be interpreted. Insurers will also need to have reference to the FCA's Finalised Guidance of 17 June 2020 which summarises the steps they will need to take to review rejected and outstanding claims in light of the Supreme Court's decision and to communicate with policyholders.

Despite the Supreme Court's very detailed judgment, it doesn't pretend to resolve every claim and there may still be issues which remain unresolved on the facts of individual cases.

In this briefing we explore the Supreme Court's key findings, before looking at the implications of the decision moving forward.

## "Disease" extensions

"Disease" clauses provide non-damage business interruption cover, broadly speaking, triggered by an occurrence or

manifestation of a notifiable disease within the vicinity, or a specified radius (e.g. 25 miles), of the insured premises.

The Supreme Court's analysis focused on a typical "disease" extension, using an example of a policy which provides cover for “any … occurrence of a Notifiable Disease within a radius of 25 miles of the Premises”. In this context, "Notifiable Disease" was defined by the policy as “illness sustained by any person resulting from… any human infectious or human contagious disease… an outbreak of which the competent local authority has stipulated shall be notified to them.”

The Supreme Court agreed with the insurers’ interpretation of the scope of cover provided under “disease” clauses of this nature, namely that they cover only relevant effects of cases of COVID-19 that occur at or within the specified radius of the premises. Later on in the judgment, when the Supreme Court comes to consider the critical issue of causation, it becomes clear that this was something of a pyrrhic victory for insurers. Nonetheless the Justices’ analysis is noteworthy for their approach to the exercise of interpretation.

In answering the question what is the scope of the peril insured against by a “disease” clause, the Supreme Court rejected the High Court’s decision that the insured peril was, in effect, the disease itself, in this case COVID-19. The Justices’ analysis focused on the ordinary, plain English language meaning of the words used, in particular the meaning of “occurrence of a Notifiable Disease”. The court referred to the well-known aggregation cases of *Axa* v *Field*[1] and *Kuwait Airways Corpn* v *Kuwait Insurance Co SAK*[2] for the well-established meaning of the word “*occurrence*” in insurance law as something that happens at a particular time and place and in a particular way.

In this case, the Notifiable Disease, defined by the policy as an illness sustained by a person from the disease in question, is the thing that must occur at a particular time and place and in a particular way. The Supreme Court also took note of the definition of Indemnity Period in the policy, which begins with the “date of occurrence”, and regarded it as implicit in this that the “occurrence” here meant something that “happens on a particular date and not something capable of extending over more than one date”.

Conversely, as the Supreme Court explained, a disease such as COVID-19 which can spread rapidly, 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 differing symptoms of greater or less severity." In comments which will be pored over by insurers and reinsurers considering aggregation of COVID-19-related losses, the Justices said that the contraction of the disease by different individuals on different days in different towns and from different sources cannot be said to be one occurrence. Still less can it be said that all the cases of COVID-19 in the country (or throughout the world) which had arisen by any given date in March 2020 constituted one occurrence.

The Supreme Court concluded that, on any reasonable or realistic view, those cases comprised thousands of separate occurrences of COVID-19. Given this, the Supreme Court ruled that each individual case of "illness sustained by any person" would amount to a separate occurrence. Therefore the Supreme Court held that, as a matter of plain language, a typical "disease" extension provides cover for business interruption caused by any cases of illness resulting from COVID-19 that occur within the specified area/radius of the insured premises. Applying the ordinary language of the extension, such clauses do not provide cover in respect of business interruption caused by individual cases of COVID-19 that occur outside of the specified area/radius.

In reaching this view, the Supreme Court considered that the High Court had erred in the exercise of interpretation and had wrongly taken into account two "fundamental" issues which the Justices considered were instead relevant solely to the separate issue of causation. These issues concerned the High Court’s observations that a typical "disease" clause does not expressly confine cover to business interruption which results only from cases of a notifiable disease within the specified area, as opposed to cases elsewhere; and, secondly, that the nature of a Notifiable Disease meant that it had the potential to affect a wide area and prompt the authorities to take action in response to an outbreak as a whole, as opposed to localised parts of it. Whilst the Supreme Court considered these to be important considerations in relation to causation, they were irrelevant to the exercise of interpretation unless it could be said that the description of the relevant insured peril in the policy was ambiguous. In this case, there was no such ambiguity: no reasonable reader could understand the words “any occurrence of a Notifiable Disease within a radius of 25 miles” to include the occurrence of such disease outside that radius. To decide otherwise would be to “stand the clause on its head”.

The Supreme Court also provided useful guidance on the interpretation of general exclusions from cover. In respect of one policy wording, the Insurer relied upon a general exclusion in respect of "epidemic and disease" as applicable. Whilst the Insurer accepted that it could not rely upon the reference to “disease” to negate the entire cover provided by the

“disease” extension, it argued that the extension and the exclusion should be read together consistently and that this was possible because “epidemic” was something different to, and narrower than, the cover provided under the extension. The Supreme Court rejected this: the assumption that the parties intended each of two seemingly inconsistent clauses in their agreement to have effect is a sound starting point where the parties to the contract would reasonably be expected to have had both clauses simultaneously in mind, but sometimes that is not a reasonable assumption. In the case of complex contractual documents, such a policy running, as in this case, to 93 pages, which themselves contemplate and provide for the possibility of inconsistency, this might not be appropriate.

In any event, the Supreme Court considered the overriding question to be how the words of the contract would be understood by a reasonable person. In the case of an insurance policy sold principally to SMEs, the person to whom the document should be taken to be addressed "is not a pedantic lawyer who will subject the entire policy wording to a minute textual analysis. It is an ordinary policyholder who, on entering into the contract, is taken to have read through the policy conscientiously in order to understand what cover they were getting."

Underwriters will wish to note that the Supreme Court appeared to be influenced by the fact that, in its view, the exclusion appeared to be “buried away in the middle of a general exclusion of contamination and pollution risks at the back of the policy”. Instead the reasonable reader would naturally assume that, if the intention had been to put a further substantive limit on the cover specifically provided 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.

Although the Supreme Court focussed in its analysis on one particular wording, it considered that the other wordings before it merited the same interpretation. Two of the sample wordings included the words “event” and “incident” as part of the description of the insured peril, which had led the High Court to decide, contrary to its decision in relation to the other disease clauses, that those extensions were confined to losses resulting only from specific occurrences of the disease within the radius. The Supreme Court disagreed: the words “event” and “incident” did not have particular significance and that, in line with its conclusions on the other disease wordings, the description of the insured peril as “any occurrence of a notifiable disease within a radius of 25 miles of the premises” made clear in any case that the clause only covered losses caused by any cases of illness resulting from COVID-19 that occur within a radius of 25 miles of the business premises.

## "Prevention of access" and "hybrid" extensions

"Prevention of access" clauses provide cover, broadly speaking, for a prevention or denial of access to or use of insured premises as a consequence of action by public authorities. The High Court found that whether there was cover was highly dependent on individual wordings.

So-called "hybrid" clauses combine elements of both “disease” clauses and “prevention of access” clauses. At first instance, the FCA was largely, but not wholly, successful in arguing that these provided cover for the pandemic.

The issues under appeal in the Supreme Court in respect of these types of extensions focussed on three questions:

- Whether prevention of access and hybrid clauses are triggered by public authority actions that do not have the force of law. For example, some businesses claim that they suffered interruption losses because of measures and other guidance issued by government, including in the prime minister’s various televised announcements during March 2020, that were never legally mandated.
- Whether prevention of access and hybrid wordings require total closure of a business, or if it is sufficient to trigger cover that there was a change in its operations – for example, by the closure of a part of the business for which the premises is used (e.g. eat-in or shop-in services)?
- Whether Regulation 6 of 26 March 2020, which prohibited people from leaving their homes without reasonable excuse, is a relevant “restriction imposed” in relation to those businesses which were permitted to remain open (e.g. supermarkets and pharmacies)?

We shall address the Supreme Court's analysis of each issue in turn.

- Must public authority measures have the “force of law” to qualify?

The Supreme Court's reasoning in respect of this question centred on "hybrid" extensions that provided cover where the insured suffered business interruption due to: “restrictions imposed by a public authority”; “closure or restrictions placed"; “enforced closure”'; “action” preventing access; and a denial or hindrance in access “imposed”.

The Supreme Court was asked to consider these wordings in the context of whether cover was triggered by so-called “general measures” (e.g. the "stay at home instruction" of the prime minister in his announcements on 16 and 18 March 2020 and the "2 metre instruction" on or around the same dates) and “specific measures” (e.g. the instruction of the prime minister for certain categories of businesses to close on 20 and 24 March 2020).

The Supreme Court agreed with the High Court that “restrictions imposed” by a public authority (and those similar wordings detailed above) would be understood as ordinarily meaning measures “imposed” by the relevant authority which are legally mandatory (or may shortly become so). “Imposed” connotes compulsion and a public authority typically exercises compulsion through the use of such powers.

Importantly, however, the Justices did not accept that a restriction must always refer to the exercise (or threatened exercise) of legal powers. The relevant test in interpreting the words used is how they would be understood by a reasonable person. So, for example, when the prime minister in his statement of 20 March 2020 instructed named businesses to close “tonight”, that was a clear, mandatory instruction given on behalf of the UK Government which a reasonable person would understand had to be complied with, regardless of whether it was legally capable of being enforced.

Importantly, the Supreme Court did not go on to consider each general and specific measure in turn to decide whether it would satisfy the test of what a reasonable person would understand by it, in particular whether it was in sufficiently clear terms to enable the addressee to know with reasonable certainty what compliance required. Accordingly if it is relevant, in an individual case, whether a particular non-mandatory government measure or announcement was a qualifying “restriction imposed” (or similar) that question is an issue which will remain to be resolved on its facts.

- What level of interference on the business is required to trigger coverage?

The Supreme Court's analysis in respect of this question focused on extensions concerning: "inability to use"; "prevention of access"; and "interruption".

As for “inability to use” insured premises, the Supreme Court agreed with the High Court (and insurers) that an impairment or hindrance in use is insufficient. However, the Justices then heavily qualified this conclusion by saying that the inability did not have to be an inability to use all of the premises for all purposes. The requirement would be satisfied either if the policyholder is unable to use the premises for a discrete part of its business activities or if it is unable to use a discrete part of its premises for its business activities. In both those situations there would be a qualifying complete inability of use.

The Supreme Court recognised that this is necessarily a fact dependent inquiry, but gave the example of a golf course allowed to remain open but with its clubhouse closed so that there is an inability to use a discrete part of the golf club for a discrete but important part of its business, namely the provision of food and drink and the hosting of functions.

The Justices emphasised, however, that there would only be cover for that part of the business for which the insured premises cannot be used. So, for example, a travel agent whose business was part walk-in sales and part internet sales could only claim in relation to the loss of walk-in business, even though all parts of the business may have suffered a downturn by the effects of the COVID-19 and the governmental measures taken.

As to “prevention” or “denial” of access wordings, the Supreme Court said that this means stopping something from happening or making an intended act impossible, as distinct from mere hindrance. In addition, and consistent with its analysis of “inability to use” (as summarised above), such an extension could potentially cover prevention of access to a discrete part of the premises and/or prevention of access for the purpose of carrying on a discrete part of the insured's business activities.

With regards to wordings requiring “interruption” of the business, the Supreme Court held that the ordinary meaning of “interruption” is capable of encompassing interference or disruption which does not bring about a complete cessation of the business, and which may even be slight, whilst recognising it will only be relevant if it has a material effect on the financial performance of the business.

- Is Regulation 6 a relevant “restriction imposed” in relation to those business which were permitted to remain open?

Insurers argued that the nature of “restrictions imposed” was such that they needed to be directed specifically at the policyholder or its use of the insured premises. Regulation 6 of 26 March 2020, which prohibited people from leaving their

homes without reasonable excuse, was not so directed but instead focussed on the general public. The High Court had rejected this argument, giving the example of a police cordon erected as a result of a murder or suicide in the street outside a shop. The cordon would result in a complete inability to use the shop but through a restriction directed not at the shop itself but at keeping the public out. The Supreme Court agreed with this analysis and rejected insurers' appeal on this point.

In summary, the Supreme Court interpreted the cover provided under "prevention of access" and "hybrid" extensions considerably more widely than the High Court at first instance. Insurers will need to review any claims affected by these issues and the findings may prompt new claims by insureds who previously thought they had no cover.

## Causation

The issue of causation is typically one of the more complex issues that claims handlers, loss adjusters and lawyers alike have to grapple with when considering insurance claims. Likewise, in the light of the Supreme Court's findings in respect of typical "disease" extensions and, in particular, its conclusion that such wordings cover only the effects of cases of COVID-19 occurring within the specified radius of the insured premises, causation issues become critically important and therefore received significant attention in the judgment.

The central issue before the Supreme Court was the appropriate application of the traditional "but for" test. In particular, insurers' position was that it was necessary for an insured to show that the loss would not have been sustained "but for" the occurrence of the insured peril. In other words, that in every case the insured peril (whether it be occurrence of disease within the specified radius of insured premises or prevention of access to or use of insured premises etc) can be said to have made a difference to whether or not the interruption loss would have happened. Insurers argued that the widespread nature of the COVID-19 pandemic in the UK meant that an insured would have suffered the same (or similar) business interruption losses even if the insured's particular business had, somehow, remained unaffected by any insured peril. Given this, it cannot be said that the interruption loss happened "but for" the insured peril – after all, it would have happened regardless. In this sense, insurers' argument was essentially the same kind of "wide area damage" argument with which the market is familiar in the context of catastrophic property losses.

The Supreme Court comprehensively rejected this argument through a whirlwind review of the 400 year history of the concept of "proximate causation" and a novel analysis of the law of concurrent causes.

*General principles*

The Supreme Court observed that in insurance law the exercise of identifying the "proximate cause" of loss is not concerned with finding the immediate cause, or that which is most proximate to the loss in time. Since the 19th century, the test has been what is the most "efficient" or effective cause of the loss. This is a common-sense exercise to be understood as the man in the street would understand causality, in the context of the policy wording, not as the scientist or metaphysician would understand it.

However, as the Supreme Court observed, it is not a matter of "unguided gut feeling". There are principles which can be identified:

- Did a peril covered by the policy have any causal involvement in the loss?
- If so, did a peril excluded from the cover also have any involvement? If there are two or more equally effective causes of loss one of which is excluded, the exclusion will generally prevail: *Wayne Tank & Pump Co Ltd* v *The Employers' Liability Assurance Corporation Ltd*[3].
- If there are two or more equally effective causes of loss at least one of which is insured and the other uninsured, then the loss is covered: *The Miss Jay Jay*[4].

However, in the *Wayne Tank* and *The Miss Jay Jay* type of cases, the insured peril was still a necessary cause of loss in a causal chain of events. As analysed by the Supreme Court, however, the COVID-19 pandemic is different, because of its decision that every single case of disease is itself a separate occurrence and insured peril.

Given that the governmental measures taken in response to COVID-19 were taken in consequence of the pandemic as a whole, and not as a result of any single instance of disease or localised cluster of cases, it cannot be said that any particular occurrence or outbreak of disease was either necessary or sufficient to give rise to any insured interruption loss.

On a traditional “but for” analysis, this would mean there is no cover, but the Supreme Court relied upon academic commentary for its argument that this would not be a common-sense result. It invoked the example of 20 people who all combine to push a bus over a cliff. Assume it is shown that only, say, 13 or 14 people would have been needed to bring about that result. It could not then be said that the participation of any given individual was either necessary or sufficient to cause the destruction of the bus. Yet it seemed appropriate, according to the Supreme Court, to describe each person’s involvement as a cause of the loss. If the “but for” test could not produce such a common-sense result, it was because of one of several inherent weaknesses in the conceptual nature of the test which meant that it should not be followed in such a case.

The Supreme Court acknowledged that, in the present case, its analysis yielded the striking result that there were not merely two or three concurrent causes of loss, but potentially hundreds of thousands depending on the numbers of cases of disease in the country at the time governmental measures were introduced. However, the Justices considered that there was nothing in principle or in the concept of causation which precluded this. In their minds, once a factual causal link had been established, the only question was whether it was a sufficiently strong link to satisfy the policy requirements.

*“Disease” clauses*

So, having determined that each occurrence of COVID-19 illness comprised an equally effective concurrent factual cause of loss, the question was whether this satisfied the causal requirements of the different clauses in the policies.

In relation to the “disease” clauses, the Supreme Court's starting point was that the parties to the policies under consideration can be presumed to have known that some infectious diseases - including a new disease (they gave the example of SARS) - can spread rapidly, widely and unpredictably. It follows that an outbreak of an infectious disease may not be confined to an arbitrary, circular area delineated by a radius of 25 miles (or whatever the radius might be) around an insured's premises. The Supreme Court held that no reasonable person would suppose that, if an outbreak of an infectious disease occurred which included cases within the relevant radius in the disease clause and was sufficiently serious to interrupt the insured’s business, all the cases of disease would necessarily occur within the radius. It was highly likely that there would also be cases outside the radius and that any public authority response would be in respect of the outbreak as a whole and not just to those cases within the radius. Accordingly the Supreme Court concluded that it could not be reasonable, or the commercial intention of the parties, to treat uninsured cases occurring outside the radius as depriving the policyholder of an indemnity in respect of interruption also caused by cases which the policy says are covered.

The Supreme Court was reinforced in this view by the observation that the application of the “but for” test in this situation would give the insurer similar protection to that which it would have had if loss caused by any occurrence of a notifiable disease outside the specified radius had been expressly excluded from cover. If insurers had wished to impose such an exclusion, it was incumbent on them to include it in the terms of the policy.

The Supreme Court therefore rejected insurers’ contention that the occurrence of one or more cases of COVID-19 within the specified radius cannot be a cause of business interruption loss if the loss would not have been suffered but for those cases because the same interruption of the business would have occurred anyway as a result of other cases of COVID-19 elsewhere in the country. It is sufficient to prove that the interruption was a result of governmental action taken in response to cases of disease which included at least one case of COVID-19 within the specified area required by the extension.

The Justices considered this interpretation to be clear and simple, according with the presumed intention of the parties to an insurance product sold principally to SMEs and often with relatively low limits. It also accorded with the parties’ desire for certainty, which the Supreme Court viewed as manifest in the fact that the parties had defined cover by reference to a hard-edged (albeit arbitrary) geographic radius.

*"Prevention of access" and "hybrid" policies*

The above analysis will also apply to those “hybrid” clauses which contain, as one element, an occurrence of an infectious disease within a specified radius of the insured premises.

However, unlike the "disease" clauses, the "prevention of access" and "hybrid" wordings require that more than one condition must be satisfied in order to establish that business interruption loss has been caused by an insured peril.

The Supreme Court disagreed with the approach of the High Court and also again rejected insurers’ argument that the

“but for” test must be applied to the "prevention of access" and "hybrid" clauses to take account of a “wide area damage” type scenario. Rather, the Supreme Court held that the reason why such losses would have occurred in any event is that there are two (or more) causes – on the one hand the composite insured peril described in the policy and on the other hand the (uninsured but not excluded) pandemic and its broader economic and social effects - each of which would by itself have inevitably brought about the loss without the other(s).

To amplify its point, the Supreme Court used another hypothetical example: two fires combine to burn down a house, although each would have done so even without the other - the fact that, because of the other fire, neither fire satisfies the “but for” test does not mean that both fires are not equally effective causes of the loss. So long as one is insured and the other not excluded, the loss will be covered.

However, the Supreme Court emphasised that the insured must still show that the insured peril is an equally effective cause of loss. If, in fact, it is determined on inquiry that the sole proximate cause of the loss was the COVID-19 pandemic itself, then there would be no indemnity. The example of the travel agency becomes relevant again: although customer access to its premises might have become impossible because of public authority measures preventing access, if it is found that the sole effective cause of the loss of its walk-in customer business was in fact the parallel travel restrictions in place and not the inability of customers to enter the shop, then the loss would not be covered.

## Trends clauses

The "trends" clauses were a key battleground in the FCA Test Case. These types of provisions govern the adjustment of insured loss to ensure, in particular, that the indemnity is not inflated by uninsured reasons. The question in the FCA Test Case was whether, and if so the extent to which, the "trends” clauses at issue in the FCA Test Case entitled insurers to reduce the indemnity to take into account the fact that, even if the insured had managed to remain open for business, it would still have suffered interruption loss because of the effects of the pandemic on wider society – in other words, do insurers get to run the “wide area damage” type argument at the adjustment of loss stage, even though this argument had already failed at the coverage stage of the analysis?

In its analysis of the "trends" clauses under consideration, the Supreme Court reviewed the history of “trends” clauses and market practice, and set out three points of guidance that will be useful for the market moving forward:

- "Trends" clauses are part of the machinery contained in the policies for quantifying loss. They do not address or seek to delineate the scope of the indemnity. That is the function of the insuring clauses in the policy.
- A "trends" clauses should, if possible, be construed consistently with the insuring clauses in the policy.
- To construe the "trends" clauses consistently with the insuring clauses means that, if possible, they should be construed so as not to take away the cover provided by the insuring clauses (since to do so would effectively transform quantification machinery into a form of exclusion).

The Supreme Court accepted that its proper interpretation of the "trends" clauses begs the question: how are "trends" clauses to be construed so as to avoid inconsistency with the insuring clauses? In its view, the simplest and most straightforward way in which the "trends" clauses should be interpreted is, absent clear wording to the contrary, by recognising that the aim of such clauses is to arrive at the results that would have been achieved "but for" the insured peril and circumstances arising out of the same originating cause. Accordingly, the trends or circumstances referred to in the clause for which adjustments are to be made should generally be construed as meaning trends or circumstances unrelated in that way to the insured peril. To apply the "trends" clause in the manner insurers proposed would transform a quantification procedure into a form of exclusion.

Using the example of a claim made by a SME under a "prevention of access" type extension, the aim of the adjustments is to arrive at figures which represent, as near as possible, the results that would have been achieved during the relevant period "but for" the prevention of access to the premises due to public authority actions and any consequences of the COVID-19 pandemic which affected the relevant part of the business concurrently with the insured peril.

As a result, absent clear wording to the contrary, insurers cannot reduce the indemnity otherwise due to the insured on the basis that the losses were caused equally by other (uninsured) perils the underlying cause of which was also the COVID-19 pandemic. COVID-19 and its various consequences must be stripped out of the calculation of how the insured's business would have fared had the insured peril not taken place. This is consistent with the Supreme Court's approach to causation (discussed above).

## Pre-trigger losses

Again, consistent with its approach to causation and the appropriate application of the "trends" clauses, the Supreme Court held that the indemnity payable for business interruption loss sustained after cover was triggered should not be reduced to reflect any downturn in the turnover of the business due to COVID-19 and which would have continued even if cover had not been triggered by the insured peril. In calculating the loss, an assumption should be made that pre-trigger losses caused by the pandemic would not have continued during the operation of the insured peril.

## The Orient Express Hotels case

The Supreme Court's treatment of the controversial case of *Orient Express Hotels* is perhaps the aspect of the judgment which will have the longest lasting impact on the insurance market going forward.

By way of re-cap, the case related to a claim by an insured for business interruption loss following hurricane damage to a hotel in New Orleans, under an all risks policy. Notably, the case was heard by Hamblen J (as he then was) on appeal from a decision of an arbitral tribunal (which included Mr George Leggatt QC, as he then was). Ten years on, Lord Hamblen and Lord Leggatt are now Supreme Court Justices and gave the main judgment in the FCA Test Case. In the 2010 judgment, both ruled that the application of the “but for” test meant that the insured could not recover its losses, as the business interruption damage would have occurred anyway because the area was subject to hurricane damage. At that time, the correct approach to the “but for” counterfactual exercise was to ask what would have happened if the “damage” had not occurred (but the hurricanes had).

Insurers relied on *Orient Express Hotels* as authority for the proposition that in the context of COVID-19 the insureds would have suffered loss anyway, even if they had not been forced by government to close or change their business operations, because the pandemic itself would have resulted in a general business downturn. Namely, when considering the counterfactual, it is necessary to strip out the governmental action but not the pandemic itself.
However, consistently with their approach in relation to causation generally, and the interpretation of the “trends” clauses, in a major blow to insurers, the Supreme Court held that *Orient Express Hotels* was wrongly decided and overruled it.

In particular, applying the analysis set out above on the question of “causation”, and using the same factual circumstances at issue in *Orient Express Hotels* as an example, the Supreme Court held that business interruption loss which arose because both the hotel was damaged; and also the surrounding area and other parts of the city were damaged by the hurricanes; had two concurrent causes, each of which was by itself sufficient to cause the relevant business interruption but neither of which satisfied the “but for” test because of the existence of the other. In such a case when both the insured peril and the uninsured peril which operates concurrently with it arise from the same underlying fortuity (the hurricanes), then provided that damage proximately caused by the uninsured peril (i.e. damage to the rest of the city) is not excluded, loss resulting from both causes operating concurrently is covered.

This outcome is likely to have significant implications for the adjustment of both property damage and non-damage business interruption claims in the market moving forward.

## Implications for the Insurance Market

Insurers and policyholders alike will now turn their attention to revisiting their policy wordings to ascertain the extent to which the Supreme Court's judgment affects claims presented to date.

In accordance with the FCA's Finalised Guidance, insurers will need to handle and assess all outstanding potentially affected claims and potentially affected complaints in line with ICOBS 8 and DISP 1 and apply the judgment in the test case so far as relevant. Any rejected claims or complaints (or those where insurers made an adjustment or deduction for general causation) should also be reassessed. They must also appropriately communicate with all affected policyholders.

The Supreme Court's findings in relation to "prevention of access" and "hybrid" extensions, such as its finding that certain measures/guidance which did not have the force of law could nevertheless still trigger coverage, may result in additional claims being brought or the indemnity payable on claims already presented increasing. Coverage and adjustment issues may also arise in individual cases which cannot be resolved by applying the Supreme Court’s judgment and these will

need to be investigated and adjusted on a case-by-case basis.

The Supreme Court's judgment did not touch upon the issue of how an insured might effectively establish the prevalence of disease within the radius for the purpose of establishing cover under "disease" or "hybrid" clauses. This may not be straightforward to establish in some cases. The position here remains as set out in the High Court judgment. The FCA is also currently consulting on its published draft Guidance this issue – responses are due by 18 January 2021 with an extended deadline of 22 January 2021 for responses on issues arising out of the Supreme Court's judgment.

There is little doubt that insurers' exposures, and therefore their reserves, will be moving upwards. This, in turn, will have a knock-on effect on their outwards reinsurance programmes.

The Supreme Court's novel approach to causation will have lawyers pondering how this can be applied in future cases across the insurance markets.

However, as touched on above, perhaps the most obvious blow to insurers (and reinsurers) is the Supreme Court's decision to overrule the insurer-friendly *Orient Express Hotels* judgment, as this aspect of the ruling is not confined to non-damage business interruption claims, but also property damage claims more generally. It remains to be seen how the market responds after the dust has settled on a judgment that will have both immediate and longer-term consequences.

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[1][1996] 2 Lloyd's Rep. 223
[2][1996] 1 Lloyd's Rep. 664
[3][1973] 2 Lloyd's Rep. 237
[4][1987] 1 Lloyd's Rep. 32

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