THE FINAL TEST: SUPREME COURT RULES ON COVID-19 TEST CASE APPEAL

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The UK Supreme Court has handed down its highly anticipated judgment in the test case on business interruption (BI) insurance coverage of Covid-19 losses which brings largely good news for BI insurance policyholders affected by the epidemic. It also resolves some challenges on causation to the scope of insurance coverage which has wider application to private law generally.

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INTRODUCTION

In its propitious judgment, the Supreme Court has given authoritative guidance on how insurers should, and courts will, interpret and apply standard business interruption (BI) insurance policies in the UK[1]. It follows the High Court's initial guidance on the operation of these policies, which we covered in our previous article, available here.

On the whole, the outcome was good for BI insurance policyholders affected by government restrictions in the wake of Covid-19. The Court dismissed most of the grounds of appeal raised by the defendant insurers and upheld some of the grounds of appeal raised by the Financial Conduct Authority (FCA) on behalf of policyholders.

Most importantly, the Court decided that each case of Covid-19 was a 'separate but equally effective' cause of government restrictions and of the interruption caused by the outbreak of Covid-19 in the UK. Accordingly, policyholders should be able to recover losses caused by Covid-19 in their local area, even if those losses would have occurred regardless of whether there was a localised outbreak of the virus. Further, the Court's approach to causation of loss will likely have wider ramifications going forward.

BACKGROUND

The FCA's test case, which proceeded on the basis of agreed facts concerning the developing response of the UK Government to the Covid-19 crisis, asked the Court to review a selection of BI insurance clauses which were broken down into three categories:

- 'disease clauses' – covering the effects of an outbreak of a disease or illness;
- 'prevention of access clauses' – dealing with the impact of government restrictions on access to insured premises; and

- 'hybrid clauses' – covering the implications of government restrictions, prompted by a disease or illness, upon access to insured premises.

The High Court decision was covered in our previous article, but it essentially found that:

- Disease clauses were generally triggered when the insured could show that at least one person within the specified area (typically a 25-mile radius of the insured premises) had Covid-19. Losses from Covid-19 were then covered whether or not they took place in the specified area;
- The scope of 'prevention of access' clauses largely turned on whether the policy covered 'the 'prevention' of access or a 'hinderance' of access. Prevention clauses were narrowly construed, and only covered losses arising out of the complete closure of a business premises; and
- Hybrid clauses were similarly construed. They were triggered following the identification of a case of Covid-19 within the specified area and turned on whether the clauses covered the prevention of access to the insured premises, or merely the hinderance or limitation of access.

KEY ISSUES ON APPEAL

On a leapfrog appeal direct to the Supreme Court the insurers and FCA each appealed certain elements of the High Court's findings. In particular, the insurers argued that:

- Even if the BI insurance policies responded to Covid-19, policyholders were likely to have suffered the same or similar losses even if the relevant 'insured peril' had not occurred; and
- The express wording of the some of the sample clauses and/or the operation of 'trends clauses' meant that the scope of recoverable losses should be substantially reduced.

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KEY FINDINGS

In summary, the Supreme Court:

- adopted a narrower approach to the application of disease clauses, but this had no practical effect to the scope of coverage due to the Court's findings on causation;
- expanded the scope of coverage for policyholders with prevention-of-access and hybrid clauses in their BI Insurance policy; and
- determined that all cases of Covid-19 were an equal cause of the government measures and the public's response to Covid-19, meaning that once coverage was triggered, all losses which could be connected to Covid-19 (or the impacts of the virus that were insured against) were recoverable by policyholders. It was not necessary to show that the losses would not have occurred but for the outbreak of Covid-19 in the immediate vicinity of the affected business.

Disease Clauses

The Supreme Court took a narrower approach to the interpretation of disease clauses which threatened to substantially narrow the scope of coverage determined by the High Court. However, as a result of the Supreme Court's treatment of the causation of loss (summarised below), this point of interpretation will have little practical effect on the quantum of losses recoverable by policyholders.

The Supreme Court disagreed with the High Court's finding that, once the disease clauses were triggered by a case of Covid-19 within the relevant limitation area, all subsequent losses caused by Covid-19 were covered by the policy. Instead, the Supreme Court decided that the disease clauses only covered losses directly caused by Covid-19 cases which occurred within the specified limitation area. The insured peril was the local outbreak of Covid-19, not the outbreak of Covid-19 generally. To determine otherwise would be, the Court considered, a distortion of the clear words of the policies, which referred to outbreaks of illness only within a specified area.

"Where a policy responded to the 'prevention or inability' of access (rather than an interruption or hinderance), the occlusion in question does not need to be total."

In order for policyholders to make a claim under a disease clause, they would need to identify that a case of Covid-19 occurred within the specified limitation area in their policy. In order to do so, the High Court decision had earlier indicated a number of ways that insured parties might prove the incidence of Covid-19 within a given area, which we summarised in our previous note. Given the rapid spread of Covid-19, it is likely that most businesses will be able to identify a case of Covid-19 as having occurred prior to, or not long after, the imposition of government restrictions. However, for policyholders in the Scilly Islands, their coverage would not have been triggered until September 2020, when the first case of Covid-19 was identified there.

Prevention of Access and Hybrid Clauses

On prevention-of-access clauses and hybrid clauses the Supreme Court departed from the High Court on two key matters – delivering big wins for policyholders in the process.

First, the Court ruled that, where a policy responded to the 'prevention or inability' of access (rather than an interruption or hinderance), the occlusion in question did not need to be total.

It would be sufficient for a business to demonstrate that they were prevented from using either:

- a discrete part of their premises for their business activities; or
- their premises for a discrete part of their business activities.

In those cases, where there was a total inability to operate part of a premises, or conduct one component of a business, coverage would respond to losses resulting from those parts of the business the policyholder was prevented from operating.

To illustrate the Court's approach, here are a few practical examples of businesses that would be covered under the Supreme Court's approach to these policy clauses:

- A department store that had to close all but the pharmacy section could be covered for its losses in the remaining parts of the store;
- A restaurant which was compelled to close its seating area, but could still operate a takeaway business could claim the loss of its dine-in revenue;
- A bookshop that was unable to use its premises to sell books to walk-in customers but could still make online sales could claim the loss of its walk-in sales;
- A travel agent, whose business comprised 50% of walk-in sales, and 50% online / tele-sales, could claim in relation to the loss of its walk-in business, but not for any reduction in its online and telephone sales caused by Covid-19.

The second key issue that the Supreme Court decided was that, in order for prevention-of-access coverage to be triggered, it was not necessary for the government to have enacted legally-binding restrictions. For instance, Prime Minister Boris Johnson's televised instruction on 20 March 2020 for certain businesses to close immediately was sufficient to trigger coverage for those businesses, even though the legally-binding regulations legislating those restrictions were introduced on 21 March and/or 26 March (depending on the nature of the business).

> "The but for test has its place in most straightforward cases of breach of contract or negligence. However, as these examples illustrate, it can be at once too broad and too narrow and can lead to results which defy common sense and are unjust."

The Supreme Court was also asked to consider policy wording that covered losses caused by an 'interruption to [business] activities'. It was asked whether that interruption referred to a complete cessation of business, or whether any interference or hinderance would suffice. The Court sided with policyholders on that issue, reasoning that interruption did not have to mean complete cessation and could include an interference (whole or partial) caused by government measures in response to Covid-19.

Causation

The key battle ground in the Supreme Court appeal was on causation. Did the "insured peril" under the policy (be it the local outbreak of a disease, or government restrictions preventing access to a premises) actually *cause* the loss that the insured was claiming?

The insurers argued that the conventional 'but for' test should be applied. Given the prevalence of Covid-19, the insurers said that most policyholders would have suffered the same or similar losses regardless of whether the insured peril covered in their policies had occurred, and that such inevitable losses should not be covered. In other words, but for the localised contagion outbreak, the insured would have nevertheless suffered the loss. If successful, this approach would have drastically and adroitly curtailed the insurers' payouts to policyholders.

However, the Supreme Court decided that the but for test was inappropriate. It gave two vivid examples to illustrate the deficiencies of the approach. It is worth paraphrasing and deliberating upon them:

1. Where a ship sinks, causing the loss of its cargo, an unlimited number of circumstances can be said to be involved in causing the loss. The choice of a particular vessel, its seaworthiness, the chosen route and the weather conditions. All of these could be factors in the loss, but it could not be said that any one of these circumstances, in itself, caused the loss.
2. Imagine an unfortunate hiker who is shot simultaneously by two hapless hunters and dies with the autopsy showing that each accidental shot would have been fatal. It cannot be said that but for one of the bullets, the death of the hiker would not have occurred.

In both of these situations the but for test produces the perverse result that there is no cause of loss.

> "The Supreme Court also found that trends clauses only operated to factor in reductions in revenue caused by circumstances entirely unconnected with the insured peril."

In the first example, it cannot be said that any one of those single circumstances was the sole and only cause of loss. Similarly, in the case of the hiker, both hunters caused the hiker's death – but, viewing each case separately, since the hiker's death would have occurred regardless, the result is that neither hunter caused the death of the hiker.

The but for test has its place in most straightforward cases of breach of contract or negligence. However, as these examples illustrate, it can be at once too broad and too narrow and can lead to results which defy common sense and are unjust.

Turning to the incidence of Covid-19 in the UK, it could not be said that any single case of Covid-19 caused the Government to introduce restrictions which caused BI losses. Rather, in the words of the Court: "*all the cases were equal causes of the imposition of national measures*." This finding was of critical importance for the application of disease clauses and hybrid clauses – Covid-19 cases occurring outside the limitation area could not be set up as a 'countervailing cause' of the losses caused by the local incidence of Covid-19.

Ultimately, the specific causal connection required depends on the precise wording of the policy. However, in relation to the policy wordings considered by the Supreme Court, it appears that most policyholders will be able to call on their policy to cover most, if not all, BI losses caused by Covid-19, provided their policy had been triggered.

Trends clauses and the Orient Express

Trends clauses operate to prevent policyholders from claiming losses which would have occurred even if the insured peril had not occurred. They are a method of quantifying loss involving modifying the baseline revenue from which BI losses are to be assessed. Trends clauses apply, and must be considered separately to, the test for causation of loss. The High Court determined that trends clauses did not apply to reduce the losses caused by Covid-19 because it was not possible to differentiate between the losses caused by a localised outbreak of Covid-19 and the broader national restrictions. However, the High Court did find that trends clauses could reduce the quantum of recoverable losses if Covid-19 had caused a downturn in business prior to coverage being triggered.

For example, applying the High Court decision, trends clauses could be applied to take into account the downturn in revenue that hotels suffered before they were directed to close, in order to reduce the quantum of recoverable loss.

However, the Supreme Court went further than the High Court in limiting the effects of trends clauses. It agreed that trends clauses did not operate to reduce the quantum of recoverable losses caused by Covid-19, regardless of whether those losses could be directly tied to a localised outbreak of Covid-19. But the Supreme Court also found that trends clauses only operated to factor in reductions in revenue caused by circumstances entirely unconnected with the insured peril.

"The Court endorsed a broad and common-sense approach to the construction of insurance clauses, the test to be applied for causation of loss and the application of trends clauses."

Applying the example of hotels, any downturn in revenue prior to the introduction of binding restrictions caused by Covid-19 could not be factored into the quantification of loss by insurers.

In reaching this conclusion, the Supreme Court decided that the High Court case of *Orient-Express Hotels Ltd v Assicurazioni General SpA*[2] was wrongly decided. That case involved the application of a trends clause to reduce the losses recoverable by a hotel affected by Hurricane Katrina – the court held that only losses caused by direct damage to the premises could be recovered (and not losses caused by the wider destruction of New Orleans). The Supreme Court rejected that approach, commenting that the trends clause in *Orient-Express* should not have reduced the quantum of recoverable losses because of damage caused by the same event which triggered coverage.

CONCLUSION

The Supreme Court decision is good news for BI insurance policyholders affected by Covid-19. The Court endorsed a broad and common-sense approach to the construction of insurance clauses, the test to be applied for causation of loss and the application of trends clauses.

However, each policy turns on its own wording. Ultimately, individual policyholders will need to carefully review their policies to determine the implications of the Supreme Court judgment, if they are covered for Covid-19 losses, when that coverage kicks in and what losses will be covered. As a starting point, the FCA has published a letter to the CEOs of UK Insurance Companies providing its own guidance as to how the Supreme Court's decision will affect the determination of BI claims.

In the meantime, the findings of the Supreme Court on causation are likely to have a wider impact beyond the immediate context of BI insurance coverage for Covid-19. In an increasingly complex and interconnected system of global commerce, there are likely to be many events of loss properly identified as multi-causal and for which difficult questions of causation will arise. As the Supreme Court decision illuminates, the but for test may be insufficient to deal with these difficult questions.

Should you wish to discuss the implications of the Supreme Court's decision in further detail, do not hesitate to contact us for more information.

[1] *The Financial Conduct Authority v Arch and Others* [2021] UKSC 1

[2] [2010] EWHC 1186 (Comm)

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