English High Court Concludes FCA Business Interruption Test Case

4 August 2020

The United Kingdom's Financial Conduct Authority's (the "FCA") test case on business interruption insurance coverage finished its virtual hearing before the High Court last week—for further details on the announcement and pre-hearing issues in connection with this matter please see our previous client update.

There are two overarching issues in dispute in this test case:

- **Coverage**: Whether the non-damage business interruption policies under their terms cover losses resulting from the coronavirus pandemic.

- **Causation**: Whether, as a matter of law and fact and in light of the business interruption policies themselves, the necessary causal link is established between the assumed losses and the relevant peril, event or circumstance that is covered, including the impact, if any, of any trends clause.

The High Court considered a representative sample of business interruption terms, agreed facts, assumed facts and specified questions (all can be found here).

The Hospitality Insurance Group Action and the Hiscox Action Group were both launched in response to refusals by certain of the insurers participating in the test case to pay out under some business interruption policies. Indeed, the Hiscox Action Group has launched its own separate arbitration process against Hiscox. Both were permitted to participate in the test case and have produced skeleton arguments and oral submissions for the court.

This client update covers, at a high level, the key disagreements between the parties' interpretation of the policies put forward through their skeleton arguments and the

subsequent virtual hearings. We also consider the likely next steps and effects on the wider insurance industry arising out of this test case at the end of this client update.

Coverage

Generally speaking, the FCA has argued for a broad interpretation of the terms of the non-damage business interruption policies. Unsurprisingly, the insurers have strongly opposed this approach. Although there are many intricacies to the interpretation of the various policy wordings, there are four key issues under consideration:

- *Public Authority Action*: One of the key points of contention between the parties is whether the Government's various "stay at home orders" constitute a trigger for the polices that require public authority action to have been taken, even where the Government orders were not backed by legislation.

    - The FCA argued that this amounted to an imposition or an order, and therefore, the consequential business closures were "enforced" for the purposes of the policies. The FCA argued that the Government is the highest public authority and that if it tells its citizens to do something, then it should be considered an order. Similarly, the FCA noted that the Government is able to, and did, prohibit certain actions through guidance and announcements (and that it is understood by the "reasonable citizen" that it is able to do so).

    - On the other hand, the insurers countered that as part of the analysis of the contractual language, the "reasonable citizen" is not relevant—MS Amlin and Ecclesiastical noted that there is no evidence of what a "reasonable citizen" would have understood from the Government's orders, and Hiscox suggested that the fact that the FCA had to resort to this construction indicates that the measures themselves were not mandatory. Without the legal power to enforce government advice as though it were a prohibition, no such advice can be taken to be a prohibition. As Hiscox observed, if the Prime Minister were to suddenly announce that people in the United Kingdom should stop smoking, this would not constitute an effective "prohibition" on smoking.[1]

- *Prevention of Access*: There has been much debate over what constitutes "prevention" and "hindrance" of access to insured premises and whether the current circumstances meet these requirements.

[1] Hiscox skeleton argument, p. 54.

- The FCA's approach can be summarised as follows: "prevention" would encompass any action that completely or partially stops the otherwise free access or use of the premises, and "hindrance" encompasses anything that would make accessing or using the business premises more difficult. The FCA also argues that the subject of the interference is unlimited, and therefore, anything that "prevents" or "hinders" the insureds would be captured under the policies. The FCA also noted that even where businesses were permitted to stay open, they experienced a "prevention" of use and access because the Government's measures prevented the business from operating normally.

- The insurers argued that the FCA's interpretation is much too broad. MS Amlin and Ecclesiastical, for example, argued that prevention of access means that access is impossible (legally or physically) rather than more difficult (which would be a hindrance).[2] The insurers also rejected the FCA's approach to businesses that were permitted to remain open but where there was a reduction in customer footfall, etc., noting that it is the insured's ability to access or use the premises that is in issue in the test case, not its customers'.

- *Vicinity*: Certain of the policies require the insured to establish that COVID-19 occurred within a specified vicinity (for example, 25 miles) of the insured premises, in some cases causing the closure or restriction on the premises in question. In the current circumstances, the question then becomes whether COVID-19, as a pandemic widespread across the country, qualifies as a trigger for coverage under the policies or whether cover is only limited to local perils.

  - The FCA supports the former interpretation. It argues that the vicinity provisions should be read such that the policies cover diseases which extend within the 25 miles (for example) but that may have a wider effect, rather than only for diseases solely to the extent that they are within 25 miles.

  - Unsurprisingly, the insurers disagreed. QBE, for example, argued that the insured is responsible for establishing the business interruption loss (if any) caused by the occurrence of the disease within the vicinity, as it is only in respect of business interruption loss caused by that event (i.e., a localised occurrence of the disease) that the insured has purchased the insurance. In addition, it was noted by Zurich that the Government's response cannot be regarded as a consequence of localised incidences of the disease—it was the result of the nationwide epidemic.

- *Prevalence*: While it is common ground that COVID-19 was a notifiable disease (or similar) and that some policies require a policyholder to demonstrate that a case of

---

[2] MS Amlin and Ecclesiastical skeleton argument, p. 94.

COVID-19 was within a certain location, there is disagreement as to the types of proof that would be sufficient to discharge the burden of proof upon the insureds and whether the evidence presented by the FCA (if it were to represent the best evidence available) would be sufficient to discharge the burden.

- The FCA argues that policyholders should be able to rely upon specific evidence of a case of COVID-19 at a particular location, as well as NHS Trust data published by the Government and location-based death data from the Office of National Statistics. The FCA also suggested the use of certain statistical methodologies, whereby the reported number of cases in a local area might be uplifted by an undercounting ratio.[3]

- The insurers argue that the court limited the scope of the discussion on the prevalence issues at the earlier case management conferences and as such, the court should not be permitted to make findings in relation to whether: (i) the FCA's evidence is the best available and (ii) that evidence can discharge the burden of proof. The insurers reiterated that they require expert opinions on these matters.

- It may be necessary for the court to hold a further hearing on the application of the methodology later in the year (likely September) if the court does find that the data the FCA relies upon is the best available evidence.

In addition to the specific issues with the terms identified above, there are other points of disagreement between the parties on the proper interpretation and construction of the policy wordings.

- *Exclusions*:

  - At various points, the FCA has sought to argue that the absence of an exclusion clause in connection with pandemics[4] should mean that the business interruption policies are covered in these circumstances, given that insurers can, and do, define and exclude cover for epidemics and pandemics, including actions relating to them.

  - However, the insurers believe that this is a circular argument - "there is no need to exclude what is not covered".[5] They argue that where the policy sets out the scope of cover in narrowly defined positive terms, it is not necessary, and would

---

[3] Determined using analysis by Imperial College, London and Cambridge University.

[4] The FCA noted one exception to this in connection with policy wording RSA3.

[5] Hiscox skeleton argument, p. 13. See also Zurich skeleton argument, p. 35.

be ineffectual and, to a degree, impossible to spell out each of the exclusions of what is not within the scope of cover under the policy.[6]

- *Insureds' Knowledge*:
  - The FCA has argued that the court should approach its interpretation of the policy wordings objectively, from the perspective of an SME business (using the often-cited example of "a restaurant owner in the suburbs") with limited knowledge of insurance matters. Indeed, the FCA indicated that the policyholders are "generally not sophisticated or well-resourced insurance buyers".[7]
  - The insurers objected to this characterisation of the insureds—Hiscox took issue with equating the insureds with consumers, noting that this "misunderstands the nature of the bargain".[8] Similarly, Arch noted that its policies were only available for sale through brokers, who would have a duty to the policyholder to consider the suitability of the policy.[9] The insurers take this one step further and also note that, in any case, the above would be irrelevant, as the wordings are clear and "clear and unambiguous language in an agreement will generally be binding on the parties".[10]
- *Expected Government Response:*
  - The FCA also noted that throughout the 20th and early 21st centuries there were a number of pandemics and epidemics (notably Spanish flu and SARS). On the basis of these, the insurance industry was aware of the potential for governmental response in the context of a pandemic. On this basis, the FCA argued that insurers could have expressly excluded cover for pandemic risk had they wished to.
  - In response to this, some of the insurers noted that the response of the UK Government to more recent pandemics has not been so severe. For example, Zurich noted that there were three influenza pandemics in the 20th century: the Spanish flu, the Asian flu and the Hong Kong flu—in the cases of the latter two, despite high estimated mortality rates in the United Kingdom, the Government did not impose lockdown measures.[11] Instead, measures were taken at a local level.

---

6 Zurich skeleton argument, p. 35.

7 The FCA referred to its own thematic review, dated May 2015, on the handling of insurance claims for SMEs, which concluded that SMEs are likely to be similar to retail customers when buying general insurance products.

8 Hiscox skeleton argument, p. 4.

9 Arch skeleton argument, p. 10.

10 Joint skeleton argument on principles of construction of contracts, p. 3.

11 Zurich skeleton argument, p. 17.

On this basis, they rejected the FCA's characterisation of the UK Government's response as inevitable.

Causation

As noted above, the second overarching issue to be determined in connection with the test case is on the issue of causation.

By way of summary, the FCA's primary case on this issue is that it is not possible to identify disease outside a distinct vicinity, or disease on the one hand as opposed to the response of the Government on the other, as separate causes that are proximate. For the FCA, the single, proximate cause is COVID-19 everywhere - alongside the Government and human response to it. In the alternative, the FCA argued that the relevant trigger under the policies in question is a proximate cause, notwithstanding that there might be other concurrent uninsured causes.

The insurers are highly critical of the FCA's view of causation.[12] They argue that the "but for" test[13] is the "essential" starting point for identifying whether the insured peril was the cause of the loss. The test of proximate causation is treated separately by the insurers—which they argue is the usual approach taken by the English courts. The suggestion "advanced obliquely" by the FCA that the "but for" test may be circumvented by the test of proximate causation, is described by the insurers as "heretical" because the "but for" test is a "necessary hurdle".

Separately, the FCA indicates that the correct counterfactual for the formulation of the "but for" test is a hypothetical scenario where there is no COVID-19 and no government intervention related to COVID-19. The insurers' approach, which the FCA described as "artificial"[14] is, generally speaking, to posit a world with COVID-19 but without mandatory restrictions by the Government.[15] Indeed, the insurers went on to state that the FCA's approach to the counterfactual is wrong because removing COVID-19 from the counterfactual would redefine and extend the nature of the cover.

---

[12] Indeed they go so far as to say that the FCA's approach is "the most transparent reverse-engineering, designed to shoe-horn all the possible causes of loss into the narrow and limited insured perils" (Joint skeleton argument on causation, p. 74).

[13] A test under English law that, at its simplest level, is used by the courts to determine whether a given peril is a cause-in-fact of the loss (by considering the effect if the insured peril did not occur).

[14] FCA skeleton argument, p. 10. The insurers note that there is no rule of law or fact that required the counterfactual to pass a test of non-artificiality.

[15] Indeed, during the virtual hearings, the FCA's counsel noted that under these conditions "it becomes nonsensical and the cover becomes genuinely illusory".

In connection with the FCA's arguments about concurrent causes, the insurers argue that, applying the principles of English law, there is no cover—their argument is that English law provides that, where the loss was proximately caused by more than one independent cause, one insured and one not, the policy will not respond because the loss cannot be said to have been caused by the insured peril (i.e., the loss would have happened as a result of the other non-insured cause).

The issue of causation also appears in relation to the "trends" clauses which are included in certain of the policies. Typically, these clauses require an adjustment of any insured business interruption loss to take account of variations in the circumstances affecting the business before and after the loss. Zurich argued that the adjustments mandated by the trends clauses necessarily require an assessment of what would have happened "but for" the insured peril. However, the FCA argues that it would be wrong to apply the ordinary "but for" test to a trends clause as this disregards the commercial purpose of such clause is to ensure that the ordinary variations of commercial practice are taken into account. The analysis of this provision, therefore, should take into account circumstances affecting the business, not the causes of interruption or loss, according to the FCA.

Effect of the Test Case

If the High Court's decision supports the FCA then insurers with business interruption exposure in the United Kingdom could experience a significant increase in pandemic-related losses. On 15 July 2020, the FCA published an updated list, based on responses from UK insurers, of business interruption policies that may be affected by the final decision on the test case. It is expected that this list may continue to be revised as the case develops. The FCA indicated that approximately 370,000 policyholders are covered by the policies included on this list.

On the final day of the virtual hearing, the court noted that it would seek to have a draft judgment prepared for the parties by the middle of September but would not bind itself to this timeframe. However, the framework agreement, entered into between the FCA and the participating insurers, does permit the parties to appeal the judgment from the High Court. Any appeal should be sought on an expedited basis, and the parties have agreed to explore the possibility and appropriateness of a "leapfrog" appeal to the Supreme Court. As such, while the test case aims to obtain judicial guidance more quickly and at lower cost to policyholders than would be the case if they took their own actions, appeals on this case will continue the cycle of uncertainty.

Policyholders are not bound by any final judgment, although a judgment in favour of insurers may discourage further litigation on these specific issues and would be something the Financial Ombudsman Service (the "FSO") should have regard to if policyholders exercised their rights to take their complaints to the FSO.

In addition, while the FCA's approach should reduce the number of competing disputes in the market, the policy language under consideration is not comprehensive and so there will likely be other ongoing disputes in connection with other business interruption policies. The test case will also not determine how much is payable under individual policies—another issue for another day.

In the meantime, the industry on both sides of the Atlantic waits with bated breath for the judgment of Flaux LJ and Justice Butcher—which is expected to be persuasive for other common law jurisdictions currently considering business interruption cases of their own.

* * *

For more information regarding the legal impacts of the coronavirus, please visit our Coronavirus Resource Center.

Please do not hesitate to contact us with any questions.

LONDON

James C. Scoville
jcscovil@debevoise.com

Clare Swirski
cswirski@debevoise.com

Benjamin Lyon
blyon@debevoise.com

Philip Orange
porange@debevoise.com

Sarah Hale
shale@debevoise.com

Katie Power
kpower@debevoise.com