UK FCA Business Interruption Insurance Test Case Judgment Handed Down

15 September 2020

The English High Court handed down a judgment today in the United Kingdom Financial Conduct Authority's (the "FCA") test case on business interruption insurance coverage.[1]

The FCA noted in its original announcement its view that most policies in the London market do not cover pandemics, and therefore most insurers will have no obligation to pay out in relation to coronavirus. Many policies, however, contain extensions of cover for business interruption which does not include damage. The test case (and its judgment) is intended to cover only certain commonly used policy wordings in non-damage business interruption policies where there is uncertainty as to whether pandemic coverage is provided. In its judgment, the High Court found for the FCA and the policyholders on a number of key points, including in respect of issues of causation and "trends" clauses. The High Court found that most, but not all, of the relevant policy wordings were triggered by the pandemic.

As we noted previously, the insurance industry, both in the United Kingdom and the United States, has been awaiting the judgment, as an important step in determining insurer responsibility for losses caused by the pandemic. We expect that this judgment will be persuasive for other common law jurisdictions currently considering business interruption cases of their own, including the business interruption cases in the United States and a recently announced test case in Australia.

The Judgment. As discussed in our previous updates, there were a number of key legal issues under consideration during the hearing and in written submissions. We have considered the High Court's approach to certain of the key issues below:

[1] For further details on the test case, please see our previous client updates here and here.

- **Causation**: Ahead of the hearing, many London (re)insurance lawyers felt the insurers had the advantage in this analysis. This, in part, was a result of the English court's prevailing interpretation of the "but for" test. However, in this case, the court dismissed the insurers' argument that the widespread nature of Covid-19 and the government advice and restrictions should be deemed competing causes of loss. For cover to be triggered, that composite insured peril must have caused the interruption or interference with the relevant business. The court found that the presence of Covid-19 in the United Kingdom constituted "one indivisible cause".

- **Business Trends**: the court found that the insurers' interpretation of the trends clauses would result in the cover becoming largely "illusory". As such, it agreed with the FCA that it would be contrary to generally held principles for a loss (that has been established by the policyholder following the insured peril) to be limited by the inclusion of part of that insured peril in the assessment of the position of the policyholder had the insured peril not occurred.

- **Exclusion Clauses**: Certain of the policy wordings before the court included exclusion clauses (including, for example, policy wordings from RSA and Argenta). The court found that, on the proper construction of the individual clauses in question, these were not applicable to losses caused by Covid-19.

- **Prevention of Access**: During the hearings, there were competing arguments as to whether social distancing measures amounted to "prevention of access", including for businesses that were able to remain open or partially open for some of the lockdown. Again, the court's analysis turned on the construction of the individual policies. However, generally speaking, the court found that, if the government's requirement to lock down entailed a fundamental change from the business as described in the policy schedule, then there was prevention of access. For example, a restaurant that started providing a takeaway service that had not ordinarily done so before the lockdown order came into effect on 26 March 2020, would have experienced prevention of access, but a restaurant that already had a takeaway service (that formed a substantial part of its business) prior to 26 March 2020 did not experience a prevention of access (although it may have been impeded or hindered for the purpose of in-house dining).

What happens next? The insurers have until October to make declarations relating to the judgment, but press reports indicate that they have asked for more time to put in an application to appeal. Press reports also indicate that the insurers have been given the right to appeal directly to the Supreme Court ("leapfrogging" the Court of Appeal). Given the expedited timetable so far, it is possible that this matter could be fast-tracked to the Supreme Court, in which case it is possible that the appeal could be heard either before Christmas or early in 2021.

The financial consequences of the final outcome to either party could be considerable. If the FCA wins in the Supreme Court, the UK insurance market will be forced to pay claims which, it would argue, it did not underwrite or expect to pay and which it did not reserve for. Insurers are already paying claims on some business interruption policies. Indeed, the Association of British Insurers has said that its members expect to pay £900 million in business interruption insurance claims this year due to the pandemic. If the Supreme Court finds for the FCA, analysts believe that this could take the size of those payments to billions of pounds.[2] Even where the Supreme Court determines that coverage exists, it is likely to take time for the insurers to properly adjust all the claims that they would receive. There is also scope for disputes between policyholders and the insurers over the quantum of loss, which is not being determined by the English courts in the test case. In any event, policyholders may be waiting a long time for any payment.

However, today's judgment does not represent a simplistic, all-or-nothing resolution. Given the myriad of wordings and the complexity of the legal issues, it was always unlikely that any judgment would be wholly in favour of the FCA or the insurers and indeed, the High Court has taken a different view on different policy wordings.

There are also other policy wordings that were not under consideration in the FCA test case but that may be affected by the judgment. The FCA published a list of policy wordings submitted to them in connection with their initial analysis. The application of the judgment to these wordings may not be entirely clear, which may result in subsequent testing in the English courts by policyholders.

In addition to the financial cost, there are additional non-financial issues that will likely arise as a result of this test case—some UK insurers are already rewriting their policies to clarify the coverage that the policies are providing and to ensure that this risk does not arise again.

While the judgment is an important stage in understanding the possible scope of liability for (re)insurers that issued policies with the applicable wordings, a final resolution to the matter is unlikely to come soon.

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[2] Analysts at Deutsche Bank estimate that there are between £3.7 billion and £7.4 billion of potential claims (assuming that the average claim will be between £10,000 and £20,000) that may be payable should the FCA be successful. Other analysts believe that the average claim will be between £25,000 and £50,000, resulting in potential claims amounting to between £9 billion and £18 billion.

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

Please do not hesitate to contact us with any questions.

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