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CLIENT ALERT

The U.K. Supreme Court Issues Ruling on Non-Physical Damage Business Interruption Cover for COVID-19 Losses

Jan.28.2021

On January 15, the U.K. Supreme Court handed down its highly anticipated decision on insurers' obligations under policies providing non-physical damage business interruption cover for infectious notifiable diseases and for prevention of access and public authority closures and restrictions. *See The Financial Conduct Authority v. Arch Ins. (UK) Ltd., et al.*, [2021] UKSC 1. The case was brought by the U.K. Financial Conduct Authority (FCA) under the Financial Markets Test Case Scheme. This scheme enables a claim raising issues of general importance to financial markets to be determined in a test case without the need for a specific dispute between the parties where immediately relevant and authoritative English law guidance is needed. Here, the U.K. Supreme Court considered if "there is cover in principle for COVID-19 related losses under a variety of different standard insurance policy wordings."

The Supreme Court considered if there is coverage in principle for COVID-19 related non-physical damage losses under four standard U.K. insurance policy wordings: (1) Disease Clauses; (2) Prevention of Access Clauses; (3) Hybrid Clauses; and (4) Trends Clauses. Notably, none of the relevant insurance policy provisions considered on this appeal required physical damage to the insured property. The U.K. Supreme Court also considered issues relating to causation, pre-trigger losses, and the continued viability of a prior High Court decision, *Orient-Express Hotels*.

Disease Clauses

Under U.K. policies, a Disease Clause generally provides coverage for non-physical damage business interruption losses resulting from any occurrence of a Notifiable Disease at or within a specified distance from the insured premises. The Supreme Court disagreed with the lower court's determination that, under these clauses, the insured peril was the disease itself (*i.e.*, COVID-19). Instead, the Supreme Court concluded that "occurrence of a Notifiable Disease" under the exemplar U.K. policies refers to each case of COVID-19 sustained by a particular person. Given this conclusion, it followed that the Disease Clause covers only cases of COVID-19 occurring within the radius of the insured premises specified in the policy (and not cases outside that area).

Prevention of Access and Hybrid Clauses

Under U.K. policies, without requiring any showing of physical damage, a Prevention of Access Clause generally provides coverage for non-physical damage business interruption losses resulting from public authority intervention that prevents or hinders access to, or use of, the insured business premises. A Hybrid Clause combines the main elements of Disease and Prevention of Access Clauses.

The Supreme Court focused on the Hiscox hybrid clause wording, which provides cover for a policyholder's "inability to use the insured premises due to restrictions imposed by a public authority during the period of insurance following . . . an occurrence of any human infectious or human contagious disease, an outbreak of which must be notified to the local authority."

The Supreme Court disagreed with the lower court on the meaning of "restrictions imposed by a public authority," and determined that language is not limited to measures with the force of law. The Supreme Court reasoned that a reasonable person would understand an instruction given by a public authority (here, the U.K. Prime Minister's instruction that named businesses to close "tonight") to be a "restriction imposed" "if, from the terms and context of the instruction, compliance with it is required, and would reasonably be understood to be required, without the need for recourse to legal powers." Under these policies, the "restrictions imposed" need not be directed at the policyholder and the insured premises, so long as the inability to use the insured premises is due to those restrictions.

In considering what constitutes an "inability to use" or "prevention of access" under these U.K. wordings, the Supreme Court agreed that an impairment or hinderance in use or access is insufficient. The decision does not require a complete inability to use or access the premises, however. An inability to use (or access) the premises is established under these U.K. policies "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." The Supreme Court cited as an example a golf course that is allowed to remain open, but with its clubhouse closed. The policyholder has an inability to use a discrete part of the premises (the clubhouse) and an inability to carry on a discrete part of its business (provision of food and drink and hosting functions).

The Supreme Court further clarified that under these "inability to use" or "prevention of access" wordings, as the FCA accepted, this cover extends only to those aspects of the business for which the premises cannot be used. For example, under these standard U.K. wordings, a travel agency that makes sales though walk-in customers, internet sales, and telephone sales can only claim for loss of walk-in business, even if all parts of its business are depressed by the effects of COVID-19 and governmental measures other than closure orders.

Causation

Turning to causation, the U.K. Supreme Court disagreed with the insurers' view that, at a minimum, policyholders were required to show "but for" causation under these wordings and existing English law. The insurers urged that to recover business losses the policyholders must show that, had there been no cases of COVID-19 within the relevant radius of their business premises, the Government would have excepted that radius from the national restrictions or otherwise altered its response.

The Supreme Court agreed that it was unlikely any policyholder could make such a showing, but determined that a "but for" test was unreasonable under the wordings at issue. The Supreme Court noted that a "but for" test can return "false positives," *i.e.*, causes that are too far remote from the effective or proximate cause of the loss itself, as well as "false negatives," *e.g.*, when two independent fires combine to burn down a property, but the loss would have occurred if only one or the other fire had occurred.

The Supreme Court instead applied a proximate cause analysis under the Disease Clause and Prevention of Access and Hybrid Clauses. Under the Disease Clause, causation is met under the exemplar U.K. wordings if the non-physical business interruption loss resulted from governmental action taken in response to cases of disease within the required radius, including at least one case of COVID-19. Under the Prevention of Access and Hybrid clauses, the exemplar U.K. policies indemnify the policyholder only against the risk of all elements of the insured peril acting in causal combination resulting in a business interruption loss.

Absent other wording, indemnity is available under these U.K. policies even if there are concurrent uncovered (but not-excluded) causes. However, no coverage is afforded for business interruption where the sole proximate cause of loss is

uncovered. For example, a travel agency may have lost business due to restrictions on travel resulting from the pandemic. Although customers were unable to access the premises, if the ***sole*** proximate cause of loss of walk-in business was the travel restrictions, and not the inability of customers to enter the premises, the loss is not covered.

Trends Clauses and *Orient Express*

Under standard U.K. policies, a Trends Clause is a method for quantifying loss, and generally provides that the amount of recoverable business interruption loss is quantified with reference to the performance of the business had the insured peril not occurred. This method builds in some notion of "but for" causation, and requires adjustments for "trends or circumstances" that would have affected the business and are unrelated to the insured peril.

Although a Trends clause quantifies loss (and does not impact the scope of indemnity), the U.K. Supreme Court declined to construe it in a way that effectively took away cover provided by the insuring clauses. "To do so would effectively transform quantification machinery into a form of exclusion." The Supreme Court rejected the insurers' position that policyholders would have suffered the same losses even in the absence of the insured peril because of the pandemic generally and other governmental orders. The Supreme Court determined that, absent contrary wording, adjustments made pursuant to a Trends Clause should reflect only circumstances unconnected with the insured peril and adjustments cannot be made for circumstances what are inextricably linked with the insured peril in the sense that they have the same underlying or originating cause.

As applied to the non-physical damage wordings at issue, business impacted by an insured peril (*e.g.*, walk-in business for Prevention of Access wordings) is not adjusted downward to reflect trends or circumstances due to the COVID-19 pandemic (which the Supreme Court considered to be the same underlying or originating cause of the insured peril). Extending this logic, the Supreme Court determined under English law that an adjustment cannot be made for any downward trend in business due to public concerns about COVID-19 that began before the insured peril is triggered.

In light of these determinations, the Supreme Court was forced to consider the continued viability of the High Court decision in *Orient Express Hotels Ltd v Assicurazioni Generali SpA* [2010] EWHC 1186 (*OEH*). The *OEH* case concerned cover for business interruption loss sustained by a hotel in New Orleans that was forced to close due to damage sustained in Hurricanes Katrina and Rita, which also devastated the surrounding area. OEH was unable to recover its business interruption losses because insurers prevailed in persuading the High Court that the business interruption loss would have occurred anyway regardless of damage to the hotel because of the hurricane damage to the surrounding area. The U.K. Supreme Court's interpretation of the Trends clause left it with no alternative but to overrule the *OEH* decision.

Concluding Thoughts

While this ruling certainly has wide-ranging ramifications for U.K. insurers that issued policies with the non-physical damage wordings at issue, it should not impact U.S. coverage determinations. As always, policy construction turns on the specific policy wording employed. The conclusions reached by the U.K. Supreme Court regarding indemnity, occurrences, causation, and the like cannot be imported to fundamentally different policies issued by U.S. insurers (requiring physical loss or damage), and certainly a careful analysis of the relevant language and legal authority is warranted in all instances.

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