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King's Bench Walk

FCA v Arch and Others [2020] EWHC 2448 (Comm): COVID-19 business interruption insurance.

The coronavirus pandemic has led to ongoing widespread business disruption and closures with a second national lockdown commencing this week. As such, certainty over whether business can bring claims under their business interruption ("BI") insurance policies could not be more important.

Arch is a test-case which the FCA, representing the interests of policy holders, brought against eight insurers and considered 21 of their BI policies. The FCA estimates that the decision in Arch will impact on 370,000 policies across all industries, from hospitality to entertainment and professional services.

The High Court adopted the FCA's categorisation of the relevant clauses, the key themes from the court's analysis of these types of clauses will be discussed below.

- **Disease**: where the policy was triggered by a notifiable disease within the vicinity / a defined area;
- **Hybrid**: clauses which refer to restrictions imposed on premises linked to the occurrence / manifestation of a notifiable disease;
- **Prevention of access / Action of Competent Authority ("AOCA")**: policies which are engaged where the premises have been closed by law.

Disease clauses

Many of the policies considered contained terms concerning business interruption following / arising out of an occurrence / manifestation of a disease within a prescribed area / vicinity of the insured business. These confirmed that:

- The link needs to be between the business interruption / inference and the notifiable disease, not between the loss and the insured peril: the causal connection requirement should give effect to and not defeat the parties intentions (see the "RSA 3" policy).
- Many of the arguments advanced by the insurers were put in terms of causation. It was held that one of the fundamental fallacies in the insurers' approach was to treat the occurrence of COVID-19 within the relevant radius or "Vicinity" of the insured premises as completely separate from its occurrence elsewhere in the country as a whole.
- Accordingly, there would be cover if a disease manifested itself both within and outside the 25-mile radius stipulated in the policy. Cover cannot be excluded by an artificial process of suggesting that the true cause of loss was incidences of the disease elsewhere which led to governmental action (see the "RSA 3" policy).

Events / Incidents

- It was found however that the "QBE 2" policy was drawing a distinction between the consequences of specific cases occurring within the radius and those not doing so, because the latter would constitute separate "events". It was also noted in the "QBE 3" policy that the fact that the radius prescribed was only one mile supported the conclusion the policy only covered the effects of the specific occurrences of the disease within the radius. As such, the insureds would only be able to recover if they could show that the case(s) within the radius, as opposed to any elsewhere, were the cause of the business interruption

Hybrid clauses

Hybrid clauses refer to restrictions imposed on premises linked to the occurrence or manifestation of a notifiable disease. There are some key takeaways.

- It was held that the phrase "restrictions imposed" (see the "Hiscox" policy) refers only to mandatory restrictions, not government guidance and exhortation (see also the "RSA 4" policy).
- It was also noted that "inability to use" premises is not to be equated with hindrance or disruption to normal use. This would not be the case for business which could stay open by virtue of the exceptions to Regulation 6 of the 26 March Regulations (see summary table of key dates and legislation at the end of this article), which include the general exception of "reasonable excuse" and the specifically enumerated exceptions including travel for the purposes of work.
- The insurers again framed many of their arguments in terms of causation. These arguments were rejected for the same reasons as set out above.

Prevention of Access / AOCA

These were policies which provided cover when access to the premises was prevented by law.

- The Arch policies insured against prevention of access clauses for various categories of policy holders. It is important to note that under these policies if a business was ordered to shut (pursuant to a mandatory government order) then the business could claim on their BI insurance if they continued to trade by setting up a new business that they had not operated previously (or had previously only been a *de minimus* part of their business). For example, there is a qualifying prevention if a restaurant set up a takeaway service which it had not carried on before, or a theatre started live streaming their shows.
- However, it should be noted that where the policyholder chose to close down the business because of reduced footfall or for some other

reason, that is not a qualifying prevention of access.
- The touchstone of prevention is impossibility (see the "MSA 3" policy).

Causation / Quantification of Damages

Trends Clauses

One of the most important aspects of the judgment concerns trends clauses. Put simply, these are clauses which are used to calculate what the insured's business profits would have been but for the occurrence of the insured peril / damage. These clauses are used to determine the counterfactual and therefore to quantify the recoverable financial loss under the policy.

"Damage"

Although many of the trends clauses considered were worded in terms of "damage" the court took a pragmatic approach and held that these clauses intended simply to put the insured in the same position as it would have been had the insured peril not occurred. Under many of the policies considered damage was interpreted purposively to include the "insured peril".

The Orient Express

The insurers relied on the decision of Hamblen J (as he then was) in Orient-Express Hotels Ltd v Assicurazioni Generali SpA [2010] EWHC 1186 (Comm) ("Orient Express"). The Orient Express was a hotel in New Orleans which suffered significant damage as a consequence of hurricanes Katrina and Rita, which also devastated the surrounding area. The insurers refused to indemnify the Orient Express essentially on the grounds that it could only recover in respect of loss which it could show would not have arisen had the damage to the hotel not occurred. Since the hurricanes had devastated the whole of the surrounding area of New Orleans, the Orient Express would have suffered the same business interruption even if the hotel had remained undamaged, since no one would have visited the hotel given the devastation in the vicinity. The insurers refused to pay out under the business interruption clause (although they paid out under the prevention of access / loss of attraction clauses, which were subject to much lower financial recovery limits) and this was upheld by the arbitration panel and on appeal by Hamblen J.

Hamblen J held that the assumption required to be made under the trends clause was "had the damage not occurred", not "had the damage and whatever event caused the damage not occurred".

However, the High court in Arch criticised Hamblen J's approach for its misidentification of the insured peril under the all-risks policy (emphasis added) at [345]:

"What we see as the fallacy in the judge's reasoning can be found in the last sentence of [52] of the judgment quoted above: However, the relevant insured peril is the damage; not the cause of that damage. The same fallacy appears in [46]-[47] and [57] which we have quoted. **The hurricanes as the cause of the Damage were an integral part of the insured peril, not separate from it.**"

It was noted that the absurdity of the Orient Express was that the policy holder was worse off the more serious the fortuity. If the hurricanes had only damaged the Orient Express hotel, there would have been full recovery for the business interruption loss suffered as a consequence of the damage, but because the overall devastation caused by the hurricanes was to the whole city and surrounding area, the Orient Express Hotel was worse off because it was to be treated as if, hypothetically, the hotel had escaped damage, but its business would still have suffered the same loss because of the devastation wrought by the hurricanes everywhere else.

The criticism of the Orient Express is *obiter*, as it was held that it could be distinguished from the present case where the policies considered concerned "composite or compound perils". For example, the prevention of access clauses considered in the Arch judgment were only triggered by the satisfaction of three elements: (i) prevention or hindrance of access to or use of the premises (ii) by any action of government (iii) due to an emergency which could endanger human life and these composite elements must have caused the business interruption or interference. The same was also true of hybrid clauses. With respect to disease clauses it was said that where there was policy cover in principle this was because the policies insured against the effects of COVID-19 both within the particular radius and outside it, as such the whole of the disease both inside and outside the relevant area has to be stripped out in the counterfactual.

Conclusion

The High Court in Arch found substantially in favour of the FCA on many of the issues and took a pragmatic and purposive approach. Only clauses which were clearly aimed at providing a localised form of cover were held not to be engaged by the occurrence of COVID-19 or where there was a clear carve-out within the policy for diseases (see the "EIO" policies).

The decision on trends clauses and the approach to the counterfactual, if it is upheld by the Supreme Court, will mean that insurers will not be able to argue that policyholders should be worse off because other businesses have also been impacted. It is likely to mean that there will be significant claims for damages under applicable BI policies. This part of the judgment is likely to be one of the central battlegrounds on appeal. Many of the insurers grounds of appeal (seeking permission to 'leapfrog' to the Supreme Court), have sought to challenge the characterisation of the insured perils as composite (and the scope of the insured period more generally), as this will reopen the causation analysis.

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1 November 2020

Key Dates from the March 2020 lockdown:

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6 March	**11 March**	**21 March**	**26 March**
COVID-19 is a notifiable disease across the UK	WHO declared COVID-19 a pandemic	The Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 made[1]	21 March Regulations replaced with Health Protection (Coronavirus, Restrictions) (England) Regulations 2020[2]

[1] The 21 March 2020 Regulations provided for the closure of certain businesses including restaurants, cafes, bars and public houses.

[2] The 26 March 2020 introduced new closures for retail shops, holiday accommodation providers and places of worship. N.B. some businesses such as accountants and lawyers, and construction and manufacturing, were not mentioned at all in either the 21 or 26 March 2020 Regulations.