Business Interruption Insurance Policies and COVID-19

I. This Article

On Friday, the Supreme Court handed down its judgment in COVID-19 business interruption insurance test case. The case considered whether and to what extent non-damage business interruption policies responded to losses caused by the COVID-19 pandemic.

The Supreme Court decision represents the third in a "trio" of cases concerning business interruption insurance policies and COVID-19. The cases are:

- *Financial Conduct Authority v Arch Insurance (UK) Ltd* [2020] EWHC 2448 (Comm) (in respect of matters not subject to the appeal);

- *TKC London Limited v Allianz Insurance Plc* [2020] EWHC 2710 (Comm); and

- *The Financial Conduct Authority & Ors v Arch Insurance (UK) Ltd & Ors* [2021] UKSC 1.

The purpose of this article is to draw together all of the strands of authority on business interruption insurance policies and COVID-19 arising from the three decisions. We have also produced a shorter summary document which gives the headlines from the Supreme Court's decision. This is available on our Chambers website.

The structure of this article is as follows:

- Disease clauses. This section considers the construction of non-damage "disease" clauses. These clauses usually refer to losses following an "occurrence" of a notifiable disease within a specified distance of the insured premises.

- Vicinity clauses. This section considers the construction of clauses referring to business interruption caused by the actions of public authorities due to "incidents" or "emergencies" likely to endanger life "in the vicinity" of the insured premises.

- Sanitary arrangements clauses. This section considers the construction of clauses relating to enforced closure of premises due to "defects" in "sanitary arrangements" at the premises.

- Prevention of access and hybrid clauses. This section considers the construction of clauses relating to restrictions imposed on premises by public authorities resulting in restrictions on the ability to use or to access the premises.

- Damage clauses. This section considers the construction of clauses which depend on triggers consisting of physical loss or damage events.

- Causation. This section explains the general approach to causation in the insuring clauses set out by the Supreme Court.

- Quantification. This section deals with discrete issues concerning the construction of "trends" clauses and the impact of "pre-trigger losses". Both were dealt with by the Supreme Court.

- Concluding comments. This section provides a brief final comment on the broader impact of the Supreme Court's ruling.

II. Disease Clauses

The clauses

These clauses provided insurance cover for business interruption loss caused by occurrence of a notifiable disease at or within a specified distance of the policyholder's business premises.

The Supreme Court considered the RSA 3 wording a good example. It said:

"We shall indemnify You in respect of interruption or interference with the Business during the Indemnity Period following: (a) any … (i) occurrence of a Notifiable Disease (as defined below) at the Premises …; (iii) occurrence of a Notifiable Disease within a radius of 25 miles of the Premises."

"Notifiable disease" was defined as "illness sustained by any person resulting from: … any human infectious or human contagious disease … an outbreak of which the competent local authority has stipulated shall be notified to them."

A "notifiable disease"

The first requirement to trigger this clause was that COVID-19 had been made a "notifiable disease".

Reasonable readers of the policy would understand it as referring to general notification measures in respect of the disease imposed by legislation. It did not matter that the policy wording actually referred to stipulation by the "competent local authority" (as opposed to a national authority).[1]

So, when did COVID-19 become generally notifiable?

- This occurred in England on 5 March 2020 by amendment to the Health Protection (Notification) Regulations 2010.

- It happened in Wales the following day (6 March 2020) by similar amendments to the Health Protection (Notification) (Wales) Regulations 2010.

- It had already been made a notifiable disease in Scotland on 22 February 2020 and in Northern Ireland on 29 February 2020.

The parties therefore agreed that, by 6 March 2020, COVID-19 had been designated a "notifiable disease" in all parts of the UK.

<u>An "occurrence" of illness "sustained by" a person</u>

The second requirement was that there was an "occurrence" of the relevant illness "sustained by" a person. What did this mean?

This had actually been decided by the High Court and this part of the decision was not challenged on appeal.[2]

The High Court held that there will have been an "occurrence" of COVID-19 within an area when at least one person who was infected with COVID-19 was in the relevant area.

It was sufficient for both the "occurrence" and "sustained by" criteria that a person contracted the disease as a matter of fact. There was no need for it to be diagnosed or symptomatic (although that might be relevant to proving that someone had contracted the disease).[3]

---

[1] *FCA* (Supreme Court) at [53]. See also *FCA* (High Court) at [375] dealing with actions taken by the local authority in the context of the Ecclesiastical Insurance Office policy.
[2] *FCA* (Supreme Court) at [53].
[3] *FCA* (High Court) at [93].

The position was different if the policy referred to a disease "manifested" by a person within the specified area.[4]

Then, the person "must either have displayed symptoms of the disease or have been diagnosed as having the disease (for example, by means of a test)". This was also decided by the High Court[5] and not challenged in the Supreme Court.[6]

"Following" an occurrence of the disease

The third requirement was that the interruption to the business was "following" an occurrence of the disease.

The parties agreed that this did not just mean "later in time" than the occurrence of the disease. There had to be some kind of causal connection between the occurrence and the business interruption[7] (although the parties disagreed about the precise nature of that causal connection).

"Occurrence" of the disease "within a radius of 25 miles of the Premises"

The central issue dispute between the parties was identification of the risk covered by this kind of wording: "any … occurrence of a Notifiable Disease within a radius of 25 miles of the Premises".[8]

The dispute can be summarised as asking whether this covered:

- The business interruption consequences only of those cases of the disease occurring within a radius of 25 miles of the insured premises (and not the consequences of occurrences outside that area); or

- The business interruption consequences of the disease wherever it occurred, provided it also occurred at least once within the 25-mile radius.

[4] For example, the QBE 1 policy did this.
[5] *FCA* (High Court) at [224].
[6] *FCA* (Supreme Court) at [84].
[7] *FCA* (Supreme Court) at [53].
[8] Some clauses had a narrower specified area, such as one mile (QBE 3). But this did not make any material difference to how they would be interpreted: *FCA* (Supreme Court) at [94].

The High Court accepted the second interpretation. It held that RSA 3 provided cover for the business interruption consequences of a notifiable disease of which there had been at least one instance, within the specified radius, from the time of that occurrence.[9]

The majority[10] of the Supreme Court disagreed. It characterised the High Court's approach as effectively rewriting the policy wording.

- The insured risk was business interruption following an occurrence of the disease "within" the specified area. The cover was not for anything occurring outside that area.[11]

- What had to happen within the specified area was an "occurrence" of the disease.[12] "Occurrence" in this context has an ordinary meaning which is "something which happens at a particular time, at a particular place, in a particular way".[13]

- On "any reasonable or realistic view", a spreading disease does not occur "at a particular time and place and in a particular way: it occurs at a multiplicity of different times and places and may occur in different ways". The best way to understand the clause was therefore "to regard each case of illness sustained by an individual as a separate occurrence."[14]

- This interpretation was supported by the definition of "notifiable disease" in the policy. It made clear that it "does not in fact … refer to a disease in any general sense" but covers the particular "illness sustained by any person" resulting from catching that disease.[15]

---

[9] *FCA* (High Court) at [102].
[10] Lord Briggs (with whom Lord Hodge agreed) thought that the High Court's approach was more in line with the construction which would be adopted by the reasonably informed reader. The approach of the majority had the same ultimate effect but was "somewhat circuitous": *FCA* (Supreme Court) at [322] and [324].
[11] *FCA* (Supreme Court) at [65].
[12] And not an "outbreak" or some other event: *FCA* (Supreme Court) at [66]. It would not include a person "who merely passes through it on a journey which involves no contact with anyone living in the area": *FCA* (Supreme Court) at [209].
[13] *FCA* (Supreme Court) at [67]. Lord Briggs (with whom Lord Hodge agreed) did not accept this analysis of "occurrence": [323].
[14] *FCA* (Supreme Court) at [69].
[15] *FCA* (Supreme Court) at [70].

- This last point was particularly significant in policies which did not actually include the word "occurred", but which still defined the "notifiable disease" in a similar way to the RSA 3 policy wording. Examples were the MSA 1 and MSA 2 policies.[16]

In summary, "As a matter of plain language, the clause covers only cases of illness resulting from COVID-19 that occur within the 25-mile radius specified in the clause."[17] The clause did not cover interruption caused by cases of illness resulting from COVID-19 that occur outside that area.

For this interpretation to apply, it was not necessary for the policy to also spell out that the loss was "in consequence of any of the following events" (with an "occurrence" being one of the "events"). The High Court had thought that this kind of wording was important[18]; the Supreme Court disagreed.[19]

What about the "outlier" policies which referred neither to a specific "illness sustained by any person" nor to an "occurrence" of the disease within the 25-mile radius, but simply to an infectious disease in general which was "manifested by any person" within the specified area?[20]

Whilst acknowledging the difference in wording, the Supreme Court held that these policies were to be construed in a similar way: "the insured peril is not any notifiable disease occurring anywhere in the world but only in so far as it is manifested by any person whilst in the premises or within a 25-mile radius of the premises."[21]

<u>General exclusion clause: loss due to "epidemic and disease"</u>

Before moving on, the Supreme Court also considered the effect of a general exclusion clause appearing many pages later in the insurance policy. This said that the policy "does not cover any loss or Damage due to … epidemic and disease".

The High Court had rejected an argument that this cut down the business interruption protection under the Disease Clause. The Supreme Court agreed that reliance on the exclusion clause had no merit.

---

[16] *FCA* (Supreme Court) at [82].
[17] *FCA* (Supreme Court) at [71] and [74].
[18] *FCA* (High Court) at [231].
[19] *FCA* (Supreme Court) at [93].
[20] For example, the QBE 1 policy.
[21] *FCA* (Supreme Court) at [85].

- The “overriding question” was “how the words of the contract would be understood by a reasonable person.”

- The “reasonable person” in the context of a policy generally sold to smaller businesses was “not a pedantic lawyer who will subject the entire policy wording to a minute textual analysis”.

- It was “an ordinary policyholder who, on entering into the contract, is taken to have read through the policy conscientiously in order to understand what cover they were getting.”[22]

- The ordinary policyholder would not have understood the general exclusion to “obliterate” the cover for business interruption caused by an infectious disease. He or she would assume that removal of a substantial part of that cover would be spelled out in the disease clause itself.[23]

The Supreme Court therefore confirmed that the general exclusion clause did not exclude claims arising out of the COVID-19 epidemic.[24]

III. Vicinity Clauses

Some clauses took a different approach in referring to business interruption caused by the actions of public authorities due to “incidents”[25] or “emergencies” likely to endanger life “in the vicinity” of the insured premises.

For example, Hiscox 2 provided cover for financial losses resulting from business interruption caused by: “An incident during the period of insurance within the vicinity of the business premises which results in a denial of or hindrance in access to the business premises imposed by the police or other statutory authority."

Wordings of this kind were considered by the High Court and were not subject of an appeal to the Supreme Court.

[22] *FCA* (Supreme Court) at [77].
[23] *FCA* (Supreme Court) at [78].
[24] *FCA* (Supreme Court) at [79].
[25] Examples were the Hiscox 2 and 4 non-damage denial of access clauses and MSA 2.

The High Court considered that the COVID-19 pandemic itself could not be described as an "incident"; nor could the mere presence of an infected person in the specified area. An incident was "something which happens at a particular time, at a particular place, in a particular way."

Clauses referring to "incidents" in the vicinity of the premises were therefore "intended to cover local incidents, of which the paradigm examples are a bomb scare or a gas leak or a traffic accident". They did not cover measures taken in response to the COVID-19 pandemic, which was "too geographically dispersed, variegated, prolonged and non-specific to amount to an incident."[26]

On the other hand, the pandemic was "an emergency likely to endanger life"[27] (and constituted a "threat or risk of injury"[28]). Where national measures were taken in response to the pandemic, could the COVID-19 "emergency" (or "threat or risk of injury") be characterised as occurring "in the vicinity" of the insured premises?

- The High Court held that the undefined term "vicinity is an elastic concept, but it does connote neighbourhood. In a given case it might encompass a greater area than the one-mile radius, in another case it might encompass a smaller area."[29] It has "a local connotation of the neighbourhood of the premises."[30]

- A requirement for the emergency itself (or a "threat or risk of injury" or a "danger"[31]) to occur "in the vicinity" of the premises was "a clear indicator that this is a narrow, localised form of cover, the paradigm example of which would be the police cordoning off an area in which the insured premises are located because of intelligence that materials for bomb-making were located in that area".[32]

- This meant that Government action in imposing regulations in response to a national pandemic "cannot be said to be following a danger in the vicinity, in the sense of in the neighbourhood, of the insured premises."[33]

[26] *FCA* (High Court) at [404]–[405], [439].
[27] See *FCA* (High Court) at [310] and [405].
[28] *FCA* (High Court) at [444] in relation to MSA 3.
[29] *FCA* (High Court) at [406].
[30] *FCA* (High Court) at [436]; [444].
[31] As in the MSA 1 or Zurich: *FCA* (High Court) at [466]; [500].
[32] *FCA* (High Court) at [444];[466]; [499].
[33] *FCA* (High Court) at [436]; [444]; [466]; [500].

- However, this approach was to be contrasted with contractually defined versions of the term "vicinity", which could be given a much wider definition – possibly (in the case of RSA 4) even "embracing the whole country".[34] Such broader defined terms could cover national measures taken in response to the pandemic.

What if all that is required is that the business interruption is caused by "actions or advice" of the Government within the vicinity of the premises? Importantly, clauses of this type did not require the "actions or advice" to "follow" or be "due to" an "emergency" or "danger" in the vicinity of the premises.

For example, RSA 4 provided cover for "the actions or advice of the police, other law enforcement agency … governmental authority or agency in the Vicinity of the Insured Locations".

The answer was that such clauses could be triggered by measures taken in response to the pandemic: "the actions or advice of the government, taken nationally and affecting all insured businesses will inevitably be in the vicinity of the insured premises if they lead to prevention or hindrance of use or access of the insured premises."[35]

IV. Sanitary Arrangements Clauses

A number of policies considered by the High Court contained clauses relating to enforced closure of the premises due to "defects" in the "sanitary arrangements".

For example:

- QBE 1 provided cover for business operation caused by: "the closing of the whole or part of the premises by order of a competent public authority consequent upon defect in the drains or other sanitary arrangements at the premises."

- Hiscox 1 provided cover for business operation caused by: "defects in the drains or other sanitary arrangements".

However, in none of the cases was it argued that closure following the government's response to COVID-19 was due to "defects" in "sanitary arrangements". Why was this?

[34] *FCA* (High Court) at [137], [140], and [406].
[35] *FCA* (High Court) at [471].

It was presumably because the clauses could only realistically be triggered by a targeted closure of the specific business due to identifiable problems in COVID-19 sanitation at the premises (as opposed to blanket national measures). The clauses are concerned with issues which are "parochial and local" to the specific business.[36]

V. Prevention of Access and Hybrid Clauses

The clauses

The Supreme Court then considered the effect of "prevention of access" and "hybrid" clauses.

An example of a prevention of access clause was found in the Arch policy. This covered:

""loss … resulting from … Prevention of access to the Premises due to the actions or advice of a government or local authority due to an emergency which is likely to endanger life or property".

The hybrid clauses were so-called because one element of the peril insured against by these clauses was the occurrence of a notifiable disease. However, they were narrower than the disease clauses (considered above), because the occurrence of the disease was combined with other elements.

An example of a hybrid clause was RSA 1. It covered:

"loss as a result of closure or restrictions placed on the Premises as a result of a notifiable human disease manifesting itself at the Premises or within a radius of 25 miles of the Premises".

Disease "occurring" or "manifesting" within a specified area

The Supreme Court started by confirming that the disease element of the hybrid clauses had to be interpreted in the same way as the disease clauses.

So, if the clause referred to "manifestation" or "occurrence" of the disease within a specified area, then it would be interpreted in the way set out above in relation to the disease clauses.[37]

What about hybrid clauses which did not impose any geographical limit on the occurrence of the disease?[38] This was dealt with straightforwardly: "If the intention had been to restrict the scope of

---

[36] This is how clauses of this type were characterised by counsel in the High Court, as recorded at [358].
[37] For example, RSA 1 (manifestation within a 25-mile radius); Hiscox 4 (occurrence within one mile): *FCA* (Supreme Court) at [100]–[101].
[38] Examples were Hiscox 1–3, which just referred to: "an occurrence of any human infectious or human contagious disease, an outbreak of which must be notified to the local authority."

the clause to any occurrence(s) of disease at or near the insured premises, the clause would have said so."[39]

Hybrid clauses without any geographical limit therefore covered the effects of notifiable diseases irrespective of where they occurred.[40]

Losses due to "restrictions imposed"

The High Court had held that "restrictions imposed" meant something both expressed in mandatory terms and which had the force of law. The High Court took the same approach in relation to similar (but distinct) wordings in a number of policies.[41]

Instructions given by the UK Government were therefore not enough. The only qualifying restrictions were those imposed by reg. 2 of the Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 and regs. 4 and 5 of the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020.[42]

The Supreme Court disagreed: "We would not … accept that a restriction must always have the force of law before it can fall within this description."[43] The test was how the words would be understood by a reasonable person. The Supreme Court gave the following guidance[44]:

- An instruction given by a public authority may amount to a "restriction imposed"[45] 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.

- This is likely to arise only in situations of emergency (such as the COVID-19 pandemic).

- Such an instruction would need not only to be in mandatory terms, but also in clear enough terms to enable the addressee to know with reasonable certainty what compliance requires.

---

[39] *FCA* (Supreme Court) at [104].
[40] *FCA* (Supreme Court) at [105].
[41] Loss due to "closure or restrictions placed" in RSA 1 [294]; "enforced closure" in RSA 4 [303]; "action" preventing access in MSA 1 [434] and Zurich 1-2 [497]; and a denial or hindrance in access "imposed" in the "Non-damage and denial of access" clauses in Hiscox 1, 2 and 4 [407]–[408] and MSA 2 [439].
[42] *FCA* (High Court) at [266]–[267].
[43] *FCA* (Supreme Court) at [116].
[44] *FCA* (Supreme Court) at [121].
[45] The analysis would also apply to other similar wordings, such as RSA 1 (which refers to "closure or restrictions placed on the Premises") and RSA 4 ("enforced closure of an Insured Location"): *FCA* (Supreme Court) at [122].

The Supreme Court did not specifically say which measures were covered, although "the argument is clearly stronger"[46] in relation to "specific measures",[47] such as:

- The instruction to schools to close given by the Prime Minister on 18 March 2020.

- The instruction to Category 1 and Category 2 businesses to close given by the Prime Minister on 20 March 2020.[48]

- The instruction to Category 6 businesses on 24 March 2020 that they "should now take steps to close for commercial use as quickly as is safely possible".

The argument is therefore presumably "weaker" in relation to "general measures",[49] such as:

- The "stay at home instruction" initially made by the Prime Minister in his announcements of 16 March 2020 and 18 March 2020.

- The instruction to stay more than two metres from others, initially contained in guidance dated 16 March 2020.

- The prohibition against gatherings initially contained in guidance dated 16 March 2020 and repeated by the Prime Minister in his announcement on that day.

<u>Did the "restriction" have to be directed at the business?</u>

The High Court[50] had accepted an argument that a prohibition on people leaving their homes without reasonable excuse[51] could be a "restriction imposed" in relation to those businesses which were allowed to stay open after "lockdown".[52]

The Supreme Court agreed with this approach. Although in most cases, the relevant restrictions would be directed at the insured premises or the use of the premises by the policyholder, they were

[46] *FCA* (Supreme Court) at [124].
[47] These were listed in *FCA* (Supreme Court) at [109].
[48] See also the example given in *FCA* (Supreme Court) at [120].
[49] These were listed in *FCA* (Supreme Court) at [110]. The "general measures" would definitely not cover "enforced closure" of insured premises: *FCA* (Supreme Court) at [124].
[50] *FCA* (High Court) at [269].
[51] Under reg. 6 of the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020.
[52] These were Category 3 and 5 businesses.

not required to be so.[53] The Supreme Court agreed with the High Court's example of a police cordon put up because of a murder or suicide which blocked access to a shop.[54]

"Inability to use" the premises

Some prevention of access and hybrid clauses covered all business interruption losses due to "restrictions imposed" by a public authority following an occurrence of a notifiable disease.

However, some were narrower than this; they would only apply where the interruption was caused by the policyholder's "inability to use" the premises.[55] What did this phrase mean?

The High Court had held that it meant a complete inability to use the premises, save for use that was de minimis.[56]

The Supreme Court agreed that an "inability" to use the premises had to be shown; an impairment or hindrance in use would not be enough. So, it would be extremely difficult for businesses allowed to stay open after lockdown to satisfy this by relying solely on the prohibition on people leaving their homes without reasonable excuse.[57]

However, the Supreme Court did not accept that "the inability has to be an inability to use any part of the premises for any business purpose."[58] The requirement was satisfied "either 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."[59]

In both of those situations there was a complete inability of use[60]:

- In the first situation, there is a complete inability to carry on a discrete business activity.

[53] *FCA* (Supreme Court) at [128].
[54] This was the example given in *FCA* (High Court) at [269].
[55] Examples of such clauses were Hiscox 1–4.
[56] *FCA* (High Court) at [268].
[57] Under reg. 6 of the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020; see Lord Hamblen and Lord Leggatt (with whom Lord Reed agreed) in the Supreme Court at [144].
[58] *FCA* (Supreme Court) at [136].
[59] *FCA* (Supreme Court) at [137].
[60] Albeit the loss is limited in extent to the part of the business for which the premises could not be used, which may only be a certain percentage of the total business: see *FCA* (Supreme Court) at [141].

A bookshop required to close its premises to walk-in customers would be "unable" to use the premises for the discrete business activity of selling books to walk-in customers, even if it could keep using the premises for telephone orders.[61]

- In the second situation, there is a complete inability to use a discrete part of the business premises.

  A department store which had to close all parts of the store except its pharmacy would potentially be a case of inability to use a discrete part of the business premises.[62]

<u>"Prevention" and "denial" of access</u>

The Supreme Court did not consider that there was any material difference between "inability to use" wordings and "prevention of access" wordings.[63]

"Prevention" meant "stopping something from happening or making an intended act impossible and is different from mere hindrance."[64] The prohibition on people leaving their homes without reasonable excuse would probably not be sufficient.[65]

Like the inability to use wordings, the prevention of access wordings could cover prevention of access to a discrete part of the premises or prevention of access for the purpose of carrying on a discrete part of the policyholder's business activities.[66]

The Supreme Court gave the example of a restaurant which closed its dining area but continued to operate a takeaway service. This would involve a prevention of access to (and inability to use) a discrete part of the premises (the dining area), and prevention of access to (and inability to use) the premises for the discrete business activity of providing a dining in service.[67]

<u>Losses resulting from "an interruption to your activities"</u>

[61] This example was provided by the *FCA* and approved by the judges: see *FCA* (Supreme Court) at [133] and [138].
[62] *FCA* (Supreme Court) at [138].
[63] *FCA* (Supreme Court) at [150].
[64] *FCA* (Supreme Court) at [151].
[65] Under reg. 6 of the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020; see *FCA* (Supreme Court) at [144] and [154].
[66] *FCA* (Supreme Court) at [151] and [155].
[67] *FCA* (Supreme Court) at [152].

Some of the clauses required the losses to result from "an interruption to your activities".[68] The High Court had held that "interruption" in this context meant "business interruption generally" and included interference or disruption, not just a complete cessation of the policyholder's business or activities.[69]

The Supreme Court agreed with this approach: "The ordinary meaning of "interruption" is quite capable of encompassing interference or disruption which does not bring about a complete cessation of business or activities, and which may even be slight (although it will only be relevant if it has a material effect on the financial performance of the business)."[70]

VI. Damage Clauses

The clauses

None of the clauses considered in the High Court (and on appeal) were "damage" clauses.

Clauses of this type, which are triggered by "loss" or "damage" to property, were considered in *TKC London Limited v Allianz Insurance Plc* [2020] EWHC 2710 (Comm).[71] This was not a full trial but was a decision on a strike-out or summary judgment application in relation to a standard-form policy.

It concerned a claim brought against Allianz Insurance Plc for business interruption losses by the owner of a café restaurant which was required to close and to cease selling food or drink for consumption on the premises by the Health Protection (Coronavirus, Business Closure) (England) Regulations 2020.

- Cover was provided under the policy for "Damage to Property Insured at the Premises", with "Damage" being defined as "Accidental loss or destruction of or damage to Property Insured".

- Cover was also provided for "Loss resulting from interruption of or interference with the Business carried on by the Insured at the Premises in consequence of an event to property used by the Insured at the Premises for the purpose of the Business". An "Event" was defined as "Accidental loss or destruction of or damage to property used by the Insured at the Premises for the purpose of the Business".

[68] These were Hiscox 1–4.
[69] *FCA* (High Court) at [274] and [409]–[414].
[70] *FCA* (Supreme Court) at [158].
[71] The case has not as far as we are aware been appealed.

- There was an exclusion for damage caused by or consisting of “inherent vice, latent defect, gradual deterioration, wear and tear …”

The claimant argued that the deterioration in its stock of food and drink held at the café whilst it was closed constituted “loss” or “damage” within the meaning of the policy. Alternatively, it argued that “loss” was capable of extending to a temporary loss of use of the premises during “lockdown”.

“Loss” in the context of a damage clause

The argument that “loss” was capable of extending to a temporary loss of use of the premises during “lockdown” was rejected by the judge on the basis of the contractual wording.

He held that “the meaning of the word "loss" in property damage insurance usually (though not invariably) has a physical element. Like the word "accident", the word "loss" takes its colour from its context. In the Property Damage Section, the immediate context for the word "loss" includes the words "destruction" and "damage". That, in my judgment, provides a pointer that "loss" here is intended to refer to physical rather than economic loss.”[72] The same was true of that word as it appeared in relation to business interruption.[73]

In summary, “the insured must show that it has been physically deprived of that property in circumstances (where it is not plainly irrecoverable) making its recovery uncertain. That is not what is alleged to have happened here.”[74]

“Accidental” loss or destruction

In respect of the “loss” of stock, this could not be characterised as “accidental”: “The word “accident" takes its colour from its context. In the phrase "accidental loss or destruction of or damage to property", the word "accidental" is not, in my judgment, apt to include the natural process of the decay or deterioration of unsold stock.”[75]

Damage consisting of “inherent vice” or “gradual deterioration”

Furthermore, what had happened to the stock was something that was caused by or consisted of "inherent vice" or "gradual deterioration". It was therefore excluded from cover by the express

[72] *TKC London Ltd* at [118].
[73] *TKC London Ltd* at [124].
[74] *TKC London Ltd* at [119].
[75] *TKC London Ltd* at [114].

terms of the policy: “Perishable food and other stock will perish in the ordinary course of events if it is left long enough. What is said to have occurred here was simply the product of the inherent characteristics of the property itself.”[76]

VII. Causation

Importance of the issue

On the High Court’s approach to the disease clauses, “questions of causation largely answered themselves.”

This was because, if the insured peril were simply COVID-19 (from the date when a case of the disease occurred within the specified distance of the insured premises), it followed that, from the date when such a case occurred, the policy covered all effects of COVID-19 on the policyholder's business.

However, the Supreme Court had rejected that interpretation. It found that the disease clauses covered only the effects of cases of COVID-19 occurring within the specified radius of the insured premises.

The question of what connection had to be shown between any such cases of disease and the business interruption loss for which an insurance claim was made was therefore critical.

Irrelevance of specific wordings

The policies used a variety of wordings in relation to the required connection between the insured peril and the loss to be indemnified. They used the words “following”; “as a result of”; “arising from”; or “in consequence of”.

The Supreme Court did not think much turned on the exact words used: “We do not think it profitable to search for shades of semantic difference between these phrases.”[77] This was because the test for causation was ultimately a legal issue rather than a “linguistic” matter.

Identifying the proximate cause

[76] *TKC London Ltd* at [115].
[77] *FCA* (Supreme Court) at [162].

The general approach to causation in insurance cases has historically been based on identifying the "proximate" cause.[78] Although this language has remained, the original concept (relating to the immediate cause of the loss) was supplanted by the notion of an "efficient" cause, meaning "something that is the agency of change."[79]

The question whether the occurrence of a peril is the proximate (or "efficient") cause of a loss involves making a judgment as to whether it made the loss inevitable in the ordinary course of events. Human actions are not generally regarded as negativing causal connection, provided at least that the actions taken were not wholly unreasonable or erratic.[80]

It has also become well established that there could be more than one proximate cause of a loss[81] (provided that the uninsured cause is not expressly excluded from cover[82]).

The Supreme Court considered that this analysis also applied to "multiple causes acting in combination to bring about a loss." They agreed with the High Court that it was realistic to analyse the COVID-19 situation as one in which "all the cases were equal causes of the imposition of national measures".[83]

Displacement of the "but-for" test by proper construction of the insurance policies

The main basis on which the insurers resisted this analysis was that it could not be said that, but for any individual case of illness resulting from COVID-19, the Government measures would not have been taken.

Since the Government response was a reaction to information about all cases of COVID-19, such an approach would make it "difficult if not impossible for a policyholder to prove that, but for cases of COVID-19 within a radius of 25 miles of the insured premises, the interruption to its business would have been less."[84]

---

[78] As codified in s. 55(1) of the Marine Insurance Act 1906.
[79] *Reischer v Borwick* [1894] 2 QB 548; *Leyland Shipping Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350.
[80] *FCA* (Supreme Court) at [168].
[81] See, for example, Lord Buckmaster in *Board of Trade v Hain Steamship Co Ltd* [1929] AC 534, 539; *JJ Lloyd Instruments Ltd v Northern Star Insurance Co Ltd (The Miss Jay Jay)* [1987] 1 Lloyd's Rep 32; *ENE Kos 1 Ltd v Petroleo Brasileiro SA (No 2)* [2012] UKSC 17 at [12] and [74].
[82] *Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corpn Ltd* [1974] QB 57; *Midland Mainline Ltd v Eagle Star Insurance Co Ltd* [2004] EWCA Civ 1042; *Atlasnavios-Navegação, LDA (formerly Bnavios-Navegação, LDA) v Navigators Insurance Co Ltd (The B Atlantic)* [2018] UKSC 26 at [49].
[83] *FCA* (Supreme Court) at [176].
[84] *FCA* (Supreme Court) at [179].

The Supreme Court's response was that there was nothing in principle precluding an insured peril that in combination with many other similar uninsured events brings about a loss with a sufficient degree of inevitability from being regarded as a proximate cause of the loss, even if the occurrence of the insured peril is neither necessary nor sufficient to bring about the loss by itself.[85]

- Whether an event which is one of many that combine to cause loss should be regarded as a cause of the loss is not a question to which any general answer can be given. It must always depend on the context in which the question is asked.

- Where the context is a claim under an insurance policy, judgements of fault or responsibility are not relevant. All that matters is what risks the insurers have agreed to cover. This is a question of contractual interpretation.

In that respect, the Supreme Court found that "the parties could not reasonably be supposed to have intended that cases of disease outside the radius could be set up as a countervailing cause which displaces the causal impact of the disease inside the radius."[86]

This was because it was "highly likely" (and would therefore have been obvious to the contracting parties) that an outbreak of a disease might include cases both inside and outside the specified area and that "measures taken by a public authority which affected the business would be taken in response to the outbreak as a whole".[87]

The Supreme Court therefore rejected the argument that the occurrence of cases of COVID-19 within the specified radius could not be a cause of business interruption loss if the same interruption of the business would have occurred anyway as a result of other cases of COVID-19 elsewhere in the country.[88]

<u>Rejection of an alternative "aggregating" and "weighing" approach</u>

The Supreme Court considered an alternative argument that the correct approach was to aggregate all the cases of disease which fell within the scope of the policy and to ask whether those cases, taken together, had an equal or similar causal impact when compared with the aggregate impact of all the cases of disease not covered by the policy.

---

[85] *FCA* (Supreme Court) at [191].
[86] *FCA* (Supreme Court) at [195].
[87] *FCA* (Supreme Court) at [194].
[88] *FCA* (Supreme Court) at [197].

Wherever in the country a policyholder's business was located, "the answer to that question will almost certainly be no."[89] That is because, wherever on a map of the UK a circle with a 25-mile radius was drawn, the number of cases which had occurred within that radius would have been relatively small compared with the total number of (uncovered) cases elsewhere.

The answer was again a question of contractual interpretation.[90]

- Apportioning the financial loss suffered by a business between different groups of cases was not realistic since the overall impact of the interrupting measures taken by the Government was indivisible.[91] An attempt to weigh the relative potency of insured and uninsured cases of disease would be practically unworkable.[92]

- Making the availability of cover depend on the number of cases of disease occurring outside the territorial limit of the policy as well as on the number within it introduced arbitrariness into the operation of the policy that lacked a rational basis.[93]

By contrast, "an interpretation that recognises the causal requirements of the policy wordings as being satisfied in circumstances where each case of disease informs a decision to impose restrictions and treats each such case as a separate and equally effective cause of the restrictions irrespective of its geographical location and the locations of other such cases avoids such irrational effects and the need for arbitrary judgments and is also clear and simple to apply."[94]

Conclusion on causation in the disease clauses

The Supreme Court's interpretation of the disease clauses of the policies therefore had a similar result to that reached by the High Court, but by a different route.[95]

Only the effects of cases occurring within the radius were covered. But those effects included the effects on the business of restrictions imposed in response to multiple cases of disease any one or more of which occurs within the radius.[96]

---

[89] *FCA* (Supreme Court) at [198].
[90] *FCA* (Supreme Court) at [199].
[91] *FCA* (Supreme Court) at [201].
[92] *FCA* (Supreme Court) at [202].
[93] *FCA* (Supreme Court) at [203] and [205].
[94] *FCA* (Supreme Court) at [206].
[95] The High Court had held that there was cover for the effects of each case of disease wherever in the country it occurred, provided that at least one case occurred within the radius specified in the clause.
[96] *FCA* (Supreme Court) at [207].

In summary, to establish causation under the policies, "it is sufficient to prove that the interruption was a result of Government action taken in response to cases of disease which included at least one case of COVID-19 within the geographical area covered by the clause."[97]

Conclusion on causation in the prevention of access and hybrid clauses

A difficulty in relation to the prevention of access and hybrid clauses was that they specified a number of causal links which had to be satisfied before the policy would respond.

For example, the relevant clause in Hiscox 1–3 covered financial losses "**resulting solely and directly from**[98] an interruption to your activities **caused by** … your 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 High Court had held that, where the peril is a composite one requiring a series of elements to be established, the "but-for" test should be applied by asking what the position of the insured business would have been if none of the elements had occurred.[99]

The Supreme Court disagreed. The effect would be to treat the insured peril as being, not the risk of all three elements occurring (in causal sequence), but the risk of any one or more of the elements occurring.[100] It would mean making the insurer liable for all consequences of the pandemic (the first link in the causative chain) rather than the narrower risk which had been agreed.

On the other hand, a counterfactual (based on the last link in the causative chain) which asked what the financial position of the business would have been in the absence of the restrictions imposed on it by public authorities would also not work. Unless the other effects of the pandemic were ignored, it would mean assuming that the relevant business was the only one left open in the UK (since other businesses would still be closed).[101]

The Supreme Court found a third way by characterising the global COVID-19 pandemic as "the originating cause" of any local occurrence of disease. In circumstances where the policy did not

[97] *FCA* (Supreme Court) at [212].
[98] This part was of less significance since it was a descriptor of the type of loss or damage covered: *FCA* (Supreme Court) at [215].
[99] Per *FCA* (High Court) at [278].
[100] *FCA* (Supreme Court) at [220].
[101] *FCA* (Supreme Court) at [223].

exclude loss "arising from such an event", other concurrent effects of the pandemic on an insured business did not reduce the indemnity under the public authority clause.[102]

What was the principle underlying this decision? It was said to be that "where insurance is restricted to particular consequences of an adverse event, the parties do not generally intend other consequences of that event, which are inherently likely to arise, to restrict the scope of the indemnity."[103]

The policies therefore indemnified the policyholder against the risk of all the elements of the insured peril acting in causal combination to cause business interruption loss; but they did so regardless of whether the loss was concurrently caused by other (uninsured but non-excluded) consequences of the COVID-19 pandemic which was the underlying or originating cause of the insured peril.[104]

This interpretation depended on a finding of concurrent causation involving causes of approximately equal efficacy. A travel agency could not recover where the loss of walk-in customers was the imposition of a travel ban rather than the inability of customers actually to enter the agency.[105]

Postscript: causation in damage clauses

Causation in "damage" clauses is likely to attract a slightly different (and more straightforward) analysis. This is because the business interruption will usually have to be caused by a physical loss or damage event.

Given the rejection in TKC London Ltd of a temporary loss of use of the premises as a "loss" event within the meaning of such policies, the alternative was for the claimant to rely on a deterioration in its stock of food and drink.

In addition to being rejected on the basis of the insured risk, this was also rejected on causative grounds: "The deterioration of TKC's stock during the period of closure did not cause TKC's business to be interrupted or interfered with, because (as is common ground) it occurred at a point at which that business was already closed as a result of the Coronavirus Regulations. It was a consequence of the interruption or interference, not its cause."[106]

---

[102] *FCA* (Supreme Court) at [240].
[103] *FCA* (Supreme Court) at [239].
[104] *FCA* (Supreme Court) at [243] and [247].
[105] *FCA* (Supreme Court) at [244].
[106] *TKC London Ltd* at [110].

VIII. Quantification

Trends clauses

All of the insurers who appealed the High Court's decision did so on this issue.

It has large financial implications. Trends clauses are part of the quantification machinery of a policy and are used to calculate what the insured's business profits would have been but for the occurrence of the insured peril.

An example is provided by Hiscox 3: "The amount we pay for loss of gross profit will be amended to reflect any special circumstances or business trends affecting your business, either before or after the loss, in order that the amount paid reflects as near as possible, the result that would have been achieved if the damage had not occurred."

Standard trends clauses calculate the loss payable under the policy by adjusting the results of the business in the previous year, to take account of "trends" or unrelated or special circumstances prevailing prior to the indemnity period which affected the business.

For example, if a company's prior annual profits had been suppressed by strikes, there would need to be an adjustment in order to estimate as nearly as possible what results would have been achieved if the insured peril had not occurred.

The insurers argued that the trends clauses had the effect that they were not liable to indemnify policyholders for losses which would have arisen regardless of the operation of the insured perils by reason of the wider consequences of the COVID-19 pandemic.

- The Supreme Court reached the same view as that of the High Court (although via different reasoning). It concluded that trends clauses do not delineate the scope of cover under the policy and should be construed consistently with the insuring clauses in the policy.[107]

- This meant that they should be construed so as not to take away the cover provided by the insuring clauses. Otherwise, they would be transformed from "quantification machinery" into a form of exclusion.[108]

[107] *FCA* (Supreme Court) at [260]–[261].
[108] *FCA* (Supreme Court) at [262]–[264].

- The Supreme Court held that "the aim of such clauses is to arrive at the results that would have been achieved but for the insured peril and circumstances arising out of the same underlying or originating cause [i.e. the COVID-19 pandemic]. Accordingly, the trends or circumstances referred to in the clause for which adjustments are to be made should generally be construed as meaning trends or circumstances unrelated in that way to the insured peril."[109]

- The first step is to identify which activities of the business were interrupted by the insured peril. The next step is, for those activities interrupted by the insured peril, to identify the income actually earned from those activities during the period of interruption. This amount is then compared with the standard turnover, adjusted to reflect any trends or circumstances which affected those activities before the occurrence of the insured peril or which would have affected them had the insured peril not occurred.[110]

- This approach means in practice that where a discrete part of a business was not interrupted by the insured peril, the relevant comparison is between the actual turnover and the adjusted standard turnover only of the interrupted activities. So, for example, if a fashion retailer had to close its shops but was still able to sell merchandise online, the trends clause will prevent the insured claiming for a fall in website sales.[111]

In summary, "the trends clauses in issue on these appeals should be construed so that the standard turnover or gross profit derived from previous trading is adjusted only to reflect circumstances which are unconnected with the insured peril and not circumstances which are inextricably linked with the insured peril in the sense that they have the same underlying or originating cause."[112]

In reaching this conclusion, the Supreme Court expressly overruled the approach in *Orient-Express Hotels Ltd v Assicurazioni Generali SpA* [2010] EWHC 1186 (Comm).

This was a case concerning the Orient-Express Hotel in New Orleans which suffered significant damage as a consequence of hurricanes Katrina and Rita, which also devastated the surrounding area.

[109] *FCA* (Supreme Court) at [268].
[110] *FCA* (Supreme Court) at [283]–[284].
[111] *FCA* (Supreme Court) at [282].
[112] *FCA* (Supreme Court) at [287].

- The insurers refused to indemnify the Orient-Express 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, as no one would have visited the hotel given the devastation in the vicinity.

- Hamblen J (as he then was) 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".

While the High Court had distinguished the *Orient-Express* case, the Supreme Court went further and said that the case was wrongly decided and should be overruled[113]: "the correct approach in the *Orient-Express* case would have been to construe the trends clause so as to exclude from the assessment of what would have happened if the damage had not occurred circumstances which had the same underlying or originating cause as the damage, namely the hurricanes."[114]

Pre-trigger losses

The High Court (subject to qualifications) had allowed adjustments to be made under the trends clauses to reflect a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered.[115]

Using the example of a pub, the High Court's approach meant that if as a result of public concern about contracting COVID-19 and the advice given by the UK Government before 20 March 2020, the turnover of the pub in the week ending on 20 March was only 70% of its turnover in the equivalent week of the previous year, that downturn would have to be accounted for when calculating the loss.[116]

[113] *FCA* (Supreme Court) at [308].
[114] *FCA* (Supreme Court) at [310].
[115] *FCA* (Supreme Court) at [289].
[116] *FCA* (Supreme Court) at [290].

The Supreme Court rejected this approach. The trends or circumstances for which adjustments may be made do not include trends or circumstances caused by the insured peril (or its underlying or originating cause).[117]

To reduce the indemnity to reflect a downturn caused by other effects of the pandemic, whenever they began, would be impermissibly to refuse to indemnify the policyholder for loss proximately caused by the insured peril on the basis that the loss was also proximately caused by uninsured (but non-excluded) perils with the same originating cause.[118]

The losses should therefore have been "assessed on the assumption that there was no COVID-19 pandemic." Consistently with that conclusion, "in calculating loss, the assumption should be made that pre-trigger losses caused by the pandemic would not have continued during the operation of the insured peril."[119]

IX. Concluding Comments

The rejection of the insurers' central arguments on contractual construction, causation, and quantum means that this decision represents a resounding victory for policyholders.

This decision has ramifications which will be felt across the insurance industry. Not only does it mandate cover under many of the 370,000 policies affected by the test case, but it will also mean that the damages paid out for policies covering other risk events will potentially be significantly greater now that *The Orient-Express* has been overruled.

The decision cannot be seen in a vacuum. The COVID-19 pandemic has been very costly. The brunt of that cost to date has been borne by the state. The practical effect of this decision is, rightly or wrongly, that part of the cost of the pandemic will now be shifted from the state onto the shoulders of the private sector.

James Beeton
Cressida Mawdesley-Thomas
12 King's Bench Walk
18 January 2021

[117] *FCA* (Supreme Court) at [294].
[118] *FCA* (Supreme Court) at [295].
[119] *FCA* (Supreme Court) at [296].