POLICYHOLDERS DEFEAT INSURERS' APPEAL IN UK FCA TEST CASE ON COVER FOR COVID-19 BUSINESS INTERRUPTION LOSSES

22 January 2021 | Australia
Legal Briefings – By **Mark Darwin, Guy Narburgh, Travis Gooding**

The momentum in favour of policyholders seeking BI cover for COVID-19 related losses continues as the English Supreme Court has unanimously dismissed the insurers' appeal against the original judgment which was largely favourable to policyholders.

Herbert Smith Freehills' London insurance team, who acted for the FCA on behalf of policyholders, has released a detailed summary of the decision which was handed down on 15 January 2021 (available here). The English Supreme Court's decision is not strictly legally binding on Australian courts but, with 5 judges of England's highest court unanimously affirming the decision of the 2 original judges, there is no reason to believe that an Australian court would decide the key issues differently. So the decision should have a major influence on the way Australian based insurers approach COVID-19 claims.

The biggest take-away from the appeal decision is that – once the elements of the policy trigger are satisfied (e.g. non-excluded disease within the relevant vicinity or a relevant action by authorities) – the fact that the wider impacts of the pandemic might have been a concurrent cause of the loss anyway cannot (unless those causes are expressly excluded) be used to reduce the claim otherwise payable under the policy.

Since our last update (available here) there have also been developments in the various Australian test cases currently ongoing. We summarise the status below.

UK FCA TEST CASE: WHAT IS IT ABOUT?

As is well known, the COVID-19 pandemic and the authorities' response to it led to widespread disruption and business closures resulting in substantial financial losses. Traditional BI policies require physical damage (which COVID-19 is not) to trigger the coverage but many businesses have sought to make claims under various 'non-damage' extensions in their BI insurance policies, such as for loss caused by "*disease at or within 25 miles of the insured premises*" or by "*actions taken by authorities in response to an emergency which prevent access or use of the premises*" etc. Insurers have denied all claims on the grounds that (they believed) these extensions were never intended to cover pandemic losses.

In response to the debate, the insurance regulator in the United Kingdom, the UK Financial Conduct Authority (**UK FCA**), used that country's novel test case procedure (which does not exist in Australia) to seek the court's rulings on the relevant governing principles. With the co-operation of eight insurers, the common issues were identified and arguments from both sides were heard in June 2020 with the original decision being delivered in September 2020 (largely in favour of policyholders – see our analysis here).

Insurers appealed the decision, and the UK FCA also appealed some minor aspects which had been resolved in favour of insurers. A 'leapfrog' appeal was allowed over the Court of Appeal straight to the English Supreme Court (England's highest court).

UK FCA TEST CASE APPEAL: WHAT WERE THE KEY FINDINGS?

The judgment is detailed and runs to 114 pages. It covers a range of issues with various degrees of relevance to the Australian market. A detailed summary of the decision prepared by the HSF team acting for the UK FCA is available here. The below summary provides some of the key takeaways.

Triggering coverage under the non-damage extensions

Disease clauses: The Appeal Court held that disease clauses insured loss caused by the occurrence of COVID-19 within the stated area (e.g. within a 25 mile radius). This was a different approach to the original decision, which had held that the loss caused by the widespread effects of COVID-19 was covered as long as there was an occurrence close enough to the business to be within the stated area. However, because of the Appeal Court's reasoning on causation, there was no difference to the outcome. The wider spread of COVID-19 was a concurrent cause of the loss, which was not excluded, so all of the loss was covered and the fact that the isolated occurrence(s) of COVID-19 within the stated area may not have been enough on their own to cause the interruption did not affect the loss claimable.

Action by authorities to prevent access or use etc: The Court gave a broader interpretation to these clauses than was given at first instance. In particular:

- **Does "action" need to be legislated?**: The original decision held that only actions with the legislative force of law could be relevant for the policy's purposes. The Appeal Court held this was too narrow – while the 'action' needed to have force of law, in the sense that legally binding measures will follow or would follow if compliance was not obtained, it did not need to be legislated. The Court gave the example of the Prime Minister announcing that certain businesses are to close but doing so prior to any legislation or enforceable order being made.

- **"Prevention" / "inability to use"**: The original decision held that only complete prevention or inability to use a premises would trigger cover. The Appeal Court also considered this to be too narrow – the prevention of a key aspect of the business or an inability to use part of the premises (such as the dining in part of a restaurant while take-away services continued) would be sufficient.

Quantifying the loss – Causation, Trends and the *Orient Express Hotels* case

Even if the policy was triggered, insurers continued to argue that the "standard" results which the business would have achieved during the period of interruption but for the insured trigger (from which the shortfall to actual results is calculated) could be adjusted to allow for the "trends and other circumstances" (being the wider impact of COVID-19) which would have affected the business anyway (even if there had been no COVID-19 within the stated area or the authorities had not closed the insured business).

This issue is deceptively complex and has slight variations depending on the specific trigger cause. In short, the Court found in favour of the policyholders by holding that once the policy trigger had established the right to cover, having regard to its view on concurrent causation, the "trends clause" (which was merely a means of quantification not coverage) could not be used to adjust for the concurrent causes.

The Appeal Court held that where insurance covers 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 coverage. In so doing, the appeal court overruled the decision in *Orient Express Hotels*[1] and held this in relation to the trends clause:

> *"we consider that 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."*

Furthermore, the Appeal Court accepted the FCA submission that any pre-trigger downturn in revenue from a concurrent cause was not a trend which could be used to adjust the revenue which would have been obtained in the indemnity period.

UK FCA TEST CASE: HOW IS THIS RELEVANT TO AUSTRALIA?

The English appeal decision is not strictly binding on Australian Courts but it can be expected to be very influential. London is the epicentre of the global insurance industry so no reasonable insurer should ignore a unanimous decision of England's highest court. Seven UK law lords have now considered the issues raised in these cases and all have found in favour of the policyholders. It would be incongruous for insurers who for years have relied on the single judge English decision in *Orient Express Hotels* to reduce claims to now refuse to follow the unanimous decision of England's highest appeal (particularly given that Lords Leggatt and Hamblen, who decided *Orient Express Hotels* in insurers' favour, have now concluded it was wrongly decided).

The key to coverage is now the scope of the policy trigger. Businesses which seek to rely on a disease extension but have had no COVID-19 within the stated vicinity of (or sometimes at) their premises will not be assisted by the English decision, nor will claims relying upon disease extensions which exclude diseases notified under the *Biosecurity Act*. Outside of Australia's largest cities, occurrences of COVID-19 in Australia were rare, such was the success of the government measures to limit the spread of the pandemic. So, many businesses will need to be able to establish the elements of an "action by authorities" extension (if any is included in their policy) in order to pursue a claim. If the elements of the relevant 'non-damage' extension can be satisfied, then the UK FCA appeal decision will be of significant assistance to Australian policyholders.

In our view, the most influential next development in this debate for Australian policyholders will be the outcome of the Star City case (based on a non-damage extension for action by authorities) which is due to be heard by the Federal Court at the end of April 2021. Our review of that case can be found here.

UPDATE ON AUSTRALIAN ICA TEST CASE APPEAL

In November last year five judges of the NSW Court of Appeal unanimously held that an exclusion in a disease extension for diseases notified under the "*Quarantine Act 1908 (Cth) and subsequent amendments*" did not exclude diseases under the *Biosecurity Act 2015* (Cth) which replaced that earlier legislation when it was repealed. Our detailed summary of that decision is available here.

Insurers do not have an automatic right to appeal but have filed an application for special leave to appeal to the High Court (available here) on the basis of two questions:

- How do the principles of contractual interpretation accommodate changes in the facts to which the contract must be applied, such as the repeal and replacement of a statute referred to in the contract?

- What are the principles applicable to the correction of 'mistakes' in contracts by construction?

The ICA needs to persuade 2 High Court judges that the issues involve questions of public importance and that it is in the interests of the administration of justice that the High Court considers the issues. If leave is granted, the merits will then be heard (i.e. granting of leave does not mean that the appeal is likely to succeed).

It is not yet known when the application for special leave will be determined but we would expect that to be this financial year on the basis that the High Court expedites the case.

Regardless, this decision will only assist policyholders whose policies were not updated to the current legislation (although if the original decision is upheld on appeal the English appeal's reasoning on causation will assist those policyholders with the quantification of their claims)

WHERE TO NOW?

This is a significant win for policyholders that will be very influential in Australian claims. However, there are still a number of ongoing test cases in Australia and policyholders should anticipate that insurers will continue their hard-line declination of claims until these tests cases have been resolved.

In addition to the above update on the Australian cases:

- the Star City Casino claim (discussed in our previous update here) continues to be listed for a hearing on 29 / 30 April 2021; and

- the ICA has indicated their intention to file a further test case dealing with issues of 'proximity' (i.e. causation) and prevention of access, although in our view this should not be necessary in light of the English Supreme Court decision on the causation and prevention of access issues.

We will continue to monitor the progress of cases and provide updates.

We will also soon be publishing the 2020 Policyholder highlights – providing a summary of the key trends and developments for policyholders in the 2020 (the 2019 edition is available here).

ENDNOTES

1. *Orient-Express Hotels Ltd v Assicurazioni General SpA* [2010] EWHC 1186 (Comm)

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

MARK DARWIN
PARTNER, BRISBANE

+61 7 3258 6632
Mark.Darwin@hsf.com

GUY NARBURGH
SPECIAL COUNSEL, SYDNEY
+61 2 9322 4473
Guy.Narburgh@hsf.com

TRAVIS GOODING
SOLICITOR, BRISBANE

+61 7 3258 6701
travis.gooding@hsf.com

LEGAL NOTICE