PRESSURE POINTS: INSURANCE FOR FINANCIAL LOSSES ARISING FROM THE PANDEMIC (UK, AUSTRALIA)

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Legal Briefings – By **Mark Darwin and Guy Narburgh**

Business has been looking to insurance to cover some of the financial consequences associated with Covid-19, and test cases have been commenced in both the UK and Australia to explore the boundaries within which insurance policies might respond to Covid-19-related losses. In this update, we consider the test case which has just been completed in the UK, which made findings generally supportive of policyholders. In the next update, we will consider the two Australian tests cases currently making their way through the courts, so that Australian policyholders might consider their own insurance cover.

WHAT IS BUSINESS INTERRUPTION (BI) INSURANCE?

BI insurance covers loss of profits and additional expenses that a policyholder suffers, *typically* as a result of physical damage to property such as following a fire or flood. There is an industry template ISR (Industrial Special Risks) Policy which is used as the base for most covers - Section 1 covers physical damage and Section 2 covers business interruption loss consequential upon the insured damage.

Some policies, however, add to the template ISR Policy to include specific extensions which trigger the Section 2 BI cover for **non-damage perils**, such as cover for BI losses caused by infectious disease at or within the vicinity of the insured premises or by the actions of authorities which prevent or hinder access to a business.

WHAT WAS THE UK FCA TEST CASE ABOUT?

The Covid-19 pandemic and the authorities response to it led to widespread disruption and business closures resulting in substantial financial losses.

Many businesses made claims seeking to recover these losses under the non-damage extensions in of their BI insurance policies.

In response to the debate and uncertainty about how BI policies would operate in the present circumstances, the insurance regulator in the United Kingdom, the UK Financial Conduct Authority (**UK FCA**), used that country's novel test case procedure – with the cooperation of eight insurers[1] and using 21 standard form policies – to get an urgent judgment on the relevant governing principles.

The judgment did not decide whether any particular policyholder or claim is covered. It simply decided the principles that insurers should apply in their coverage determinations. A detailed summary of the 162 page judgment can be read here.

WHAT TYPES OF POLICY WORDINGS WERE CONSIDERED IN THE UK FCA CASE?

The UK FCA case considered non-damage extensions to coverage in two broad categories:

- **Disease wordings**: which provide cover for business interruption in consequence of or following or arising from the occurrence of a notifiable disease within a specified radius of the insured premises.
- **Prevention of access / actions by a competent authority wordings**: which provide cover where there has been a 'prevention' (or in some wordings, a 'hindrance') of access to the premises as a consequence of the actions by authorities in response to a danger or emergency in the vicinity of the premises.

The test case also consider the insurers argument that, even if the policies were triggered, **the "trends" clause** (which requires a comparison between actual results and the results which would have been achieved having regard to the 'trends of the business' even if the insured peril had not occurred) meant that there was no claim because (they argued) the policyholders would have suffered the BI losses anyway due to a downturn in trading from Covid-19 throughout the community.

WHAT WAS DECIDED IN THE UK FCA TEST CASE?

The English High Court (the equivalent of an Australian State Supreme Court - sitting with 2 judges) found in favour of the UK FCA (and therefore policyholders) on the majority of the key issues, although the devil is in the details.

PROPER CONSTRUCTION OF THE INSURED PERIL

Early in the judgment, the court made the following observation:

While much of the argument was understandably put in terms of the nature of the causal requirements, we consider that what underlies the dispute in relation to causative requirements is a difference as to the nature of the peril insured, and that this depends on a proper construction of the relevant terms of Extension vii. Once that question of construction is answered, it seems to us that the issues of causation will also largely have been answered, and in particular it will have been established which matters can be said to be separate, non-insured causes which could be seen as distinct from the insured peril.

This observation - that you must first understand the insured peril - may seem obvious, but it underscores the approach adopted by the court as it analysed each of the different policy wordings. The first step in any claim is therefore one of construction of the relevant insuring clause or coverage extension being relied upon. This is necessary to establish a clear understanding of the peril being insured against.

EACH EXTENSION MUST BE CONSIDER CAREFULLY

Coverage will naturally depend on the specific wording used in the policy in question. However, the UK High Court, faced with a range of policy wordings, provided a useful and detailed analysis of those wordings. The first way that the judgment is useful for policyholders is effectively as a reference guide to see whether:

- the wording of the extension used within their policy has been directly considered by the UK judgment; or
- phrases used within the extension they are seeking to rely on are discussed in the UK judgment. For example, the court considered the meanings of phrases such as ‘prevent’, ‘vicinity’, and ‘actions or advice’ by a government authority.

While, this first step requires a detailed case by case analysis of the extension used, there are also some general comments which can be made about the approach taken by the court.

INSURED PERILS CAN BE ‘COMPOSITE PERILS’

First, the insured peril can be a 'composite peril' consisting of multiple aspects. For example in relation to a particular 'prevention of access' clause, the court noted:

On a proper analysis of these insuring clauses, as with others which the Court is considering, the insured peril is a composite one involving three interconnected 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.

The court held that these requirements together form the 'insured peril' for the purposes of the policy. This then has important ramifications for later questions of causation and the circumstances which are to be assumed not to have occurred in the application of the trends and other circumstances clause (which will be discussed in later Catalyst updates).

OCCURRENCES OF COVID-19 FORM ONE INDIVISIBLE PART

Second, to the extent that particular extensions are dependent upon outbreaks of Covid-19, the court held that individual outbreaks form indivisible parts of the one broader outbreak. Essentially, individual outbreaks cannot be treated separately from occurrences of the disease elsewhere.

As a result, subject to the wording of the particular extension, policies providing coverage for the occurrence of a notifiable disease are not confined to providing coverage for the effects only of the local occurrence of the disease (although a local occurrence of the disease may be required to enliven the extension which means that, unlike the UK where the disease was widespread, many Australian policyholders will not have a claim under the 'disease' extension). This interpretation also has important consequences for questions of causation and the application of the trends and other circumstances clause.

PREVENTION OF ACCESS/ACTION BY AUTHORITY WORDINGS:

The FCA had mixed success in arguing for these non-damage triggers to apply.

Where the trigger was the actions of authorities to prevent access in response to a danger or emergency 'in the vicinity' of the premises, they were construed more restrictively and turned closely on the specific terms of each policy.

First, only legislated, enforceable actions were sufficient, as opposed to mere advice or recommendations of the government which did not have the force of law. This is one of the issues being appealed.

Second, only complete closure amounted to 'prevention' (in clauses which did not also refer to 'hindrance'). This is another finding being appealed.

Third, where policies did not define ‘vicinity’, cover would only be triggered where the action of the authority was in response to the localised occurrence of Covid-19 ‘in the neighbourhood’ of the insured premises, and so action taken in response to the Covid-19 pandemic as a whole would not be sufficient. Note that one wording (Arch) did not include a ‘vicinity’ requirement and coverage was held to be triggered by the national health orders where the ‘prevention’ criteria (i.e. complete closure) was satisfied – this wording is most closely aligned with the wording in the Star City Casino policy which the subject of a test case in Australia (which we will deal with next week).

TRENDS CLAUSE

Insurance losses are typically limited to the loss caused by the stated trigger for coverage (i.e. caused by the insured peril). Further, cover is typically subject to a ‘trends and other circumstances’ clause which requires the assessment of the effect of ‘trends and other circumstances’ which would have affected the business during the interruption period even if the insured trigger had not occurred.

In essence, insurers argued that the wider impact of the pandemic was a ‘trend or other circumstance’ that would have affected the businesses anyway, even (for example, no government action was taken). That is, they argued that only the loss caused by the government action over and above that which would otherwise have been caused by the Covid-19 pandemic should be recoverable.

The court rejected this argument. The purpose of the trends and other circumstance clause is to put the insured in the position they would have been in had the insured peril not occurred. Specifically the court noted that:

> *..insurers’ approach is an artificial one which ignores the inextricable connection between the various elements of the insured peril, both as a matter of legal analysis and as a matter of practical reality, given the nature of the pandemic emergency.*

As discussed above, generally:

- the insured peril in question is a composite one – it includes both the relevant action by an authority as well as the circumstances that gave rise to it; and
- individual occurrences of the disease formed part of an indivisible whole (making it artificial to treat them separately). These points are being appealed by insurers.

Put simply, the court considered that it would be artificial to assess the policyholder’s loss by reference to a situation where the specifically covered circumstance had not occurred but the broader pandemic had still occurred. Instead, at least once the specific trigger had occurred, the effect of the pandemic was to be ignored when calculating the policyholder’s loss.

This is a significant finding in the world of insurance claims. In making that finding, the court said that the *Orient Express Hotel* case[2] (OEH) was not relevant (because the facts of the test case involved a non-damage trigger) but that if it had been relevant, the court would not have followed OEH as it was wrongly decided (in the sense that it excluded only the damage to the insured premises whereas it should have excluded the damage **and** the insured peril (hurricane) which caused that damage). This important issue is one of the main planks of the insurers appeal.

FCA AND INSURERS LODGE APPEAL IN UK INSURANCE TEST CASE

Both the UK FCA and insurers have appealed against the decision of the English High Court.

Insurers main grounds of appeal are against the findings that:

- Despite the requirement for the disease to be located within a specified (e.g. 25 mile) radius of a business to trigger the cover, Covid-19 throughout the UK was an indivisible cause of the loss which was sufficient to trigger the disease extension (where there was no exclusion for notifiable diseases);

- The effects of the Covid-19 disease/emergency was an element of the insured peril and therefore – save for any downturn that occurred before the insured peril (disease/closure/action etc) triggered the cover – when applying the 'trends clause' to estimate what results a business would have been achieved (to compare with actual results in order to calculate the claim) all elements of the insured peril had to be stripped out of the counterfactual analysis – that is, assume no Covid-19 emergency and no action by the authorities, rather than simply no action by the authorities while the pandemic spread through the community. Insurers seek to re-instate the "OEH principle", from the *Orient Express Hotel* case, in which the court upheld the denial of a claim by a hotel which was damaged by Hurricane Katrina, on the basis that an undamaged hotel would not have been trading normally anyway given that nobody was visiting New Orleans in the aftermath of the hurricane.

The FCA is appealing several findings seeking clarity for policyholders, including that:

- only legislated, enforceable actions were sufficient to amount to an action by an authority (as opposed to, on the FCA's case, advice or recommendations of the government even though without the force of law). [Note that this is not an issue in Australia because there was no impact of Covid-19 on our economy until the government

started legislating matters such as the banning of flights from China and then a series of lockdowns under various health regulations following agreement in the national cabinet)];

- only complete closure amounted to ‘prevention’ (in clauses which did not also refer to ‘hindrance’); and

- the trends clause permits an adjustment for any downturn in revenue due to Covid-19 which had already occurred before the insurance policy trigger. The FCA argues that the level of downturn pre-trigger (if as a result of a peril contemplated by the insuring clause) should not be taken into account in assessing standard turnover of a business at the point cover is triggered. To do so (as the court appeared to in certain examples in the judgment) is inconsistent with their finding that, when applying the trends clause, all elements of the insured peril should be stripped out of the counterfactual.

Both sides are seeking leave to ‘leap frog’ the Court of Appeal and go direct to the UK’s highest court, the Supreme Court (equivalent to Australia’s High Court).

Next week we will deal with the Australian test cases and how the UK decision may impact claims by Australian policyholders.

For further information and comment, please contact Mark Darwin on 0412 876 427 or mark.darwin@hsf.com

ENDNOTES

1. Arch Insurance (UK) Ltd; Argenta Syndicate Management Ltd; Ecclesiastical Insurance Office Plc; MS Amlin Underwriting Ltd; Hiscox Insurance Company Ltd; QBE UK Ltd; Royal & Sun Alliance Insurance Plc; Zurich Insurance Plc

2. Which denied the claim of a hotel in New Orleans which was damaged by Hurricane Katrina, on the basis that an undamaged hotel would not have been trading normally given that nobody was visiting New Orleans in the aftermath of the hurricane.

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

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