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COVID-19 Briefing: Good News For Small Business Policy Holders

On 15 January 2021 the Supreme Court handed down its 114-page Judgment in the Financial Conduct Authority (FCA) test case on business interruption insurance and claims arising out of business closures caused by the COVID-19 pandemic and the resulting Government action.

COVID-19 and measures taken in response have caused heavy financial losses to businesses. Many businesses believed their insurance policies provided sufficient cover for any losses arising out of business interruption. Thousands of claims were, however, declined by insurers on the grounds that the policies did not cover the effects of the pandemic.

THE FINANCIAL CONDUCT AUTHORITY TEST CASE

The FCA brought the test case (in essence on behalf of policy holders) under the special procedure of the Financial Markets Test Case Scheme. It was heard in the High Court last Autumn and both the FCA and the 8 insurers involved appealed by way of leapfrog appeal to the Supreme Court.

The case considered some 21 policy wordings thought to affect around 370,000 policy holders. It is therefore quite significant to a lot of people. Fortunately for policy holders, in the main, the Supreme Court has decided in favour of policy holders. The broad effect of the judgment is that:

- Most clauses of the type considered will provide cover for business interruption losses caused by the pandemic.
- Trends clauses (see below) will not reduce the indemnity payable because of uninsured effects of the COVID-19 pandemic. Insurers will not be able to rely on the wider effects of the COVID-19 pandemic to reduce indemnity. However, there will still be argument and negotiation regarding the calculation of those losses.
- More policy holders will have valid claims and some payouts will be higher.

Business Interruption insurance is a sub-set of insurance and does have some technicality. The Court considered the following general types of clause and issues:

- Disease clauses
- Prevention of access clauses
- Trends clauses
- Causation generally

DISEASE CLAUSES

The clauses under consideration were generally to provide cover for any occurrence of a notifiable disease (it was accepted that COVID-19 was such a disease with effect from 6 March 2020) at or within a specified radius (generally 25 miles) of the business premises. Most disease clauses are structured as an extension of cover for business interruption arising from physical damage to the business premises.

The court held that on a proper construction of the clauses, the insured peril was only an occurrence within the specified radius and that it did not cover the COVID-19 pandemic more generally. This was contrary the decision of the High Court. This also meant that the Supreme Court then had to deal with the wider issue of causation where occurrences both within and without the specified radius caused the interruption to business.

PREVENTION OF ACCESS

The discussion was around whether such prevention had to have the force of law and whether the prevention or restriction of use had to be of the whole business premises (for example a restaurant that had to close for table service but continued to provide a take-away service).

The Court held:

- That restriction of access did not have to have the force of law to trigger the relevant cover. In other words when the Prime Minister in his statement on 20 March 2020 said he was telling businesses to close, that was sufficient, even though the regulations came into force later.
- That such cover could potentially be triggered by the prohibition on leaving home, i.e., it did not have to be directed to the actual policy holder.
- That the clauses provided cover for:

  a) Inability to use a discrete part of the premises or

  b) Inability to carry on a discrete part of the business' activity.

  as a result of the prevention of access.
- Prevention of access included prevention of access to a discrete part of the premises or to the whole or part of the premises which prevented the business from carrying on a discrete part of its business activities.

Importantly, there had to be an inability to use all or part of the premises as opposed to mere hindrance or disruption to such use. There is clearly still room for some argument between insurer and insured business here.

CAUSATION

In insurance speak, causation concerns the proximate cause of the insured peril. This is a consideration of whether the loss claimed would have been suffered regardless of whether the insured peril had occurred or not. It can also involve consideration of a chain of causation or two causes of the loss, one of which is covered by the policy and one of which is not, but both are equally causative of the loss.

As stated above, the Supreme Court held that only an occurrence of the disease within the specified radius was an insured peril. Therefore, the Court had to grapple with the issue of causation where closure of businesses was as a result of the Government's response to COVID-19 nationally.

The Court held:

- The effects of an occurrence within the radius (and so an insured peril) included restrictions imposed in response to multiple cases any one or more of which occurred within the radius.
- With regard to "proximate cause" it was sufficient for the insured business to prove that the interruption was the result of Government actions in response to cases of the disease, which included at least one within the specified radius in the policy terms.

In summary, provided the closure of the business is or was the result of Government action and the result of an occurrence of the disease there is cover even if there were or are other concurrent and equal causes of the business interruption loss.

TRENDS CLAUSES

These are technical clauses in business interruption policy wordings. In general terms they provide the mechanism for calculating the loss. The way most work is that "standard turnover" and "standard revenue" are calculated from the previous calendar year's trading which is compared to the actual turnover and revenue for the period of indemnity. The general calculation is then to derive a gross profit from the comparison year and multiply the reduction in turnover by this amount to arrive at the recoverable loss.

This again involved a complex discussion regarding causation and effects on a business attributable to the pandemic generally as opposed to from an insured peril. This, in turn, encompassed the issue of whether what were termed pre-trigger effects on the business should or should not be brought into account when assessing or adjusting the calculation of loss.

The Court emphasised that trends clauses were a mechanism for quantifying loss and did not define the scope of indemnity or cover.

The Court held:

- One should first consider which activities have been affected by the insured peril – for example, a shop may be obliged to close but able to continue with on-line sales.
- Then one should identify the actual income for the affected activities.
- This is then compared with the turnover adjusted to reflect trends or circumstances affecting the business before the occurrence of the insured peril or for what would have affected the business had the insured peril not occurred – BUT these did NOT include trends or circumstances arising out of the pandemic (which is what the insurers had argued for).
- This means that there should be no adjustment for a downturn in business prior to an occurrence of COVID-19 within the specified radius due to for example reduced footfall caused by the Prime Minister announcing that we should stay at home.
- There should be an adjustment for trends or circumstances only for those unconnected with the insured peril and NOT for circumstances inextricably linked to the insured peril.
- Pre-trigger losses or trends of the pandemic should not be adjusted for – for example: if before a pub closed because of

the Prime Minister's announcement on 20 March 2020 and the 21 March 2020 Regulations it had a 70% downturn in business for the week to 20 March 2020 compared to the same week the previous year there should be no adjustment for that when assessing the loss due to business interruption (i.e. no 70% reduction in the loss calculated). This finding is very much in favour of insured businesses in the context of the specific circumstances of the COVID-19 pandemic.

CONCLUSION

This judgement by the Supreme Court Judgment is good news for small businesses. However, it is reasonable to anticipate that there will still be disputes with insurers regarding calculation of loss. It is also anticipated that the FCA will update its claims handling guidance in the light of the Judgment.

Businesses who have made claims and whose insurers maintain their declination of cover should seek legal advice and consider the policy wording and the reasons their insurers have stated for declining cover. If, on a proper analysis, the policy does not respond then a business may have a claim against its broker for failing to obtain the cover requested. Notwithstanding that the Supreme Court judgment is favourable to insured businesses there will still be those who thought they had cover and find they do not. In these cases, it is expected that there will be negligence claims against brokers.

A further possible consequence of the Judgment is that it will mean some very significant pay-outs for insurers. This is likely to lead to a hardening of the market and higher premiums. So perhaps not all good news.

PEACE OF MIND THROUGH DIFFICULT TIMES

This document was prepared on **22nd January 2021**, however in these uncertain times, the only thing we can say for certain is that nothing will stay the same for long.

It is entirely possible, therefore, that since this document was prepared new legislation may have been introduced which means that all or part of this briefing no longer reflects the current law.

Because of this, we ask you to consider that, although correct at time of printing, information in this sheet may no longer be up to date and it is always best practice to consult with a lawyer about anything contained in this briefing.

Our lawyers are available to help answer any of your questions about this issue or to help with any other legal concern you have.

Please contact Fraser Dawbarns directly for up-to-date information on your specific circumstances.

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