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A glimmer of hope for some business interruption policyholders?

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Published by
Anastasia Klein

Earlier this week the High Court handed down its judgment on the business interruption ("BI") insurance test case brought by the Financial Conduct Authority ("FCA") against 8 of the big insurance companies.

Background

As might be expected, given the widespread disruption and significant damage to businesses caused by the pandemic, BI policy holders have been seeking to rely on their BI cover to mitigate some of their losses. Many claims were rejected, leading to significant confusion and frustration between insurers and the insured. This, along with a number of complaints received by the FCA, prompted the body to bring the test case at the High Court, "in order to resolve the lack of clarity and certainty that existed for many policy holders making business interruption claims and the wider market".

Standard BI policies generally offer cover for financial losses due to interruption to a business caused by material damage to a property out of which the business operates. Losses can include time loss, consequential loss and loss of profits. Some policies however go beyond physical damage, and refer to interruption caused by disease or prevention of access. The FCA's case sought to clarify the extent to which BI insurance policies should cover these "non-damage" related losses linked to COVID-19.

Decision

To the surprise of some sceptics, the High Court found in favour of the arguments advanced for policyholders by the FCA on the majority of key issues, prompting headlines such as the BBC's, "small firms [have been] thrown a lifeline".

The Court considered some 21 different types of policy wording across 17 sample BI policies provided by 8 different insurers. It is important to note that basic or standard BI policies, which offer cover only as a consequence of property damage, were not addressed by the test case, there being no link between COVID-19 and physical damage to property. It is fairly well established now that people with that level of cover will not be able to bring a BI insurance claim. The test case related only to the meaning of non-damage BI policy wording.

The Court broadly classified non-damage BI clauses into the following 3 categories:

- **Disease clauses** – these provide BI cover where a potential claim arises because there is a notifiable disease within a specified vicinity of the premises. Here the High Court found that (i) COVID-19 is a disease and (ii) there is no requirement to demonstrate satisfaction of a narrow vicinity test, because the national outbreak was treated as potentially affecting the whole of England and Wales.

- **Denial of access clauses** – these provide cover where access to or use of premises is prevented or hindered as a result of government or local authority action or restrictions. The High Court stated that generally, these clauses should be construed more restrictively than disease clauses, in particular when looking at the vicinity test. The court also concluded that, where BI policies require that restrictions are "imposed", this only applies to restrictions imposed by statutory instrument, so for example guidance or advice (including the formal announcements made in the few days leading up to the national lockdown) would not be a sufficient trigger for BI cover. We should also question what type of business was in occupation and whether the business would have been able to trade. For example, the law requiring restaurants to close did not stop them operating a take-away service, so the impact of the statutory restrictions was different for different business models.

- **Hybrid clauses** – these clauses contain a mix of both disease and denial of access clauses, and cover a situation where restrictions on access are imposed by government or local authority because of a notifiable disease. Again, there is no need to satisfy narrow vicinity requirements, but the prevention of access wording in this situation required something more substantial than an impairment of normal use.

Overall, the High Court held that most of the disease clauses it considered would trigger BI cover. Some denial of access clauses would also be covered, but that this is much more reliant on the detailed wording of the clause and how the business was affected by the Government's response to the pandemic.

The judgment established some broad principles, but parties still need to consider the specific wording of any policy as well as particular circumstances of the claimant. Policyholders must look at their policies and consider them against the detailed judgment, to work out what it means for that policy and their own circumstances.

Insurer's Response

Following the High Court's judgment, the FCA asked the insurers to review relevant non-damage BI policies that might be affected. The list compiled by the FCA following this exercise suggests that the outcome of the claims of approximately 370,000 policy holders (under 700 policies, issued by 60 insurers) might be affected. The FCA also estimates that each successful claim could potentially run to tens of thousands of pounds.

Clearly for policyholders who can satisfy these requirements, and subject to any appeal, there is some cause for optimism. This optimism has also spread to the insurers, who despite an estimated collective figure of £1.2bn in terms of overall payouts, have seemingly avoided their

individual worst case scenarios. Shares in both Hiscox and RSA rose (by 15% and 4% respectively) following the ruling, as they outlined the size of the pay outs they expect to make (Hiscox c£100m and RSA c£104m), and confirmed that they had avoided their own worst forecasts.

The insurers can of course, appeal the High Court's decision, and most commentators anticipate that they will. The FCA has urged the insurers to make any appeal quickly to prevent any further confusion. In any event, if an appeal is to go ahead, the parties to the test case have agreed that they will use an expedited process, possibly including a "leapfrog" appeal to the Supreme Court (circumventing the Court of Appeal).

In the meantime, the FCA has set out its expectation that insurers write to policyholders within 7 days of the judgment, to explain next steps. Even if there is an appeal, policy holders can still seek to settle their claims before any appeal outcome is issued.

Impact on the Property Industry

Whilst it is not yet clear how this judgment, or any subsequent appeal judgment might affect occupiers and landowners, our initial reflections are as follows:

- Business occupiers have the most to gain from the decision.
- Tenants may choose to pay their arrears with any insurance monies received, although in most cases that would be at their discretion.
- Payments to occupiers might help prevent or delay insolvency, leading to a reduction in the anticipated number of void commercial units.
- Most landlords have either reached compromises or are dealing with unpaid rent as a separate issue. Where a landlord has entered into some sort of rent concession, they will still be bound by it, even if the tenant subsequently recovers under a business interruption policy, unless there was a right to clawback in those circumstances.
- It is likely that the terminology and principles established by the High Court will impact upon the drafting of COVID-19 and wider pandemic clauses in leases.
- Any "victory" on policy wording is likely to be short-lived, as in our view it is likely that the decision will trigger new insurance exclusions, unless there is government action to stop this (like the terrorist related Pooled Re fund, but for pandemics).
- It is possible that specific pandemic insurance might become available and if so, that Landlord's might require tenants to have this in place, or to cover the cost of the landlord providing such cover.

For now, the High Court decision is good news for many non-damage BI policyholders and is helpful in establishing some broad principles, but the key message remains that the specific wording of any policy will be critical. It is also very likely that the insurers will appeal to the Supreme Court, so we anticipate that this is not the end of the story.