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Business Interruption Insurance: FCA Test Cases

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The outcome of the UK Financial Conduct Authority's recent test cases gives hope to Irish businesses looking to make successful claims. As ever, the devil is in the detail.

COVID-19 has caused untold hardship to many Irish businesses, especially those in the hospitality and entertainment sectors.

Many small and medium-sized businesses, such as pubs and restaurants, saw their turnover decimated overnight, as the public was advised to stay at home and public health regulations were enacted. Businesses holding insurance policies containing business interruption clauses moved their focus to the policy wording in place.

The general principle of business interruption insurance is that an insured entity will be compensated for loss of turnover or profit as a result of an incident or occurrence which adversely affects or prevents the operation of the business. A typical example would be an outbreak of an infectious disease at or in the vicinity of the business premises or a fire which leads to the closure of the business.

Business interruption clauses often define an "infectious disease" by reference to an exhaustive list of specific infectious diseases. As a novel virus, COVID-19 had not been identified when many of the affected Irish businesses took out their policies. In other policies, an "infectious disease" was described as one which is notifiable to health authorities in Ireland, which includes COVID-19 since February 2020.

In cases where business interruption clauses are responsive to COVID-19, the arguments typically centre around a number of questions:

- Does COVID-19 need to occur on the business premises or within a specified distance of the business premises?
- Does COVID-19 need to be contracted by somebody at the business premises?
- the specific business premises need to be closed by authorities or will a reduction in turnover/profit alone be enough?
- Does access to the business premises need to be restricted?
- What happens where there are multiple possible concurrent causes for the reduction in turnover/profit, such as loss of public confidence, stringent public health regulations and forced closures?

Small and medium-sized businesses may not have the financial strength to launch court or arbitral proceedings challenging declinatures by insurers.

In the UK, the Financial Conduct Authority (FCA), the insurance regulator in that jurisdiction, initiated a test case on 9 June 2020 to determine issues of principle in relation to policy coverage under various specimen wordings underwritten by eight different insurers. It was agreed between the FCA and the insurers that the High Court in England would consider a representative sample of standard-form business interruption policies issued by the eight insurers. The court was asked to consider 21 "lead" policy wordings.

Lord Justice Flaux and Mr Justice Butcher, sitting together in the English High Court, heard the test case in an expedited manner, with judgment handed down on 15 September 2020, only approximately three months after the proceedings were initiated.

The English court's utterances are particularly significant in respect of a number of policy constructions:

Policies requiring an occurrence of a notifiable disease within a specified distance of the insured premises

In relation to "disease clauses", one of the policy wordings considered by the court required "any occurrence of a Notifiable Disease within a radius of 25 miles of the Premises". While the insurers in question appeared to accept that there would have been occurrences of COVID-19 (a notifiable disease) within 25 miles of insured businesses' premises, the insurer argued that, had there been no occurrence of COVID-19 within a 25 mile radius of insured premises, the businesses would still have suffered from a general reduction in demand and would also have suffered from the impact of the UK government's social distancing guidelines. The insurer argued that those restrictions would have been introduced anyway by reason of the occurrence or feared occurrence of the disease in areas other than within the 25-mile radius.

The court found against the insurer on this point, concluding that the correct way to analyse the matter is to say that the proximate cause of the business interruption is the "Notifiable Disease", of which the individual outbreaks form indivisible parts.

Policies which respond to restrictions or prohibitions imposed by public authorities

For one of the sample policies to cover business interruption losses, there needed to be financial losses caused by the insured entity's "inability to use the insured premises due to restrictions imposed by a public authority during the period of insurance".

The FCA contended that there was cover under such a clause given that restrictions were imposed in March 2020 by the UK Government in relation to non-essential travel, avoiding inter-personal contact, social distancing and so on. The FCA contended that the "restrictions imposed by a public authority" did not have to involve mandatory requirements, having the force of law, and that it would be enough if an authority professed something that it "requires or expects" to be followed.

The insurer in question argued that the "restrictions" referred to, particularly because of the use of the word "imposed", must be mandatory and legally binding. The insurer argued that legally binding statutory regulations (or similar measures) were required to meet the criteria under the relevant clause.

Agreeing with the insurer, the court found that the only relevant matters which constituted "restrictions imposed" are those which were promulgated by statutory instrument (or similar measures). The court found that "guidance, exhortation and advice given by the [UK] Government, including by the Prime Minister, including as to social distancing, do not count as "restrictions imposed" by a public authority."

The court indicated that a restriction or closure direction generally needs to be "legally capable of being enforced" by a governmental authority or other body. Interestingly, the court suggested that, where such an authority or body makes a non-binding direction, this may be sufficient to trigger policy wording if it is accompanied by a threat that a legally binding order will be obtained if the non-binding direction is not voluntarily followed.

Policies requiring prevention of access to premises and similar wordings

The court considered the meaning of the phrases "prevention of access" and "hindrance of access" to premises or to their use as a consequence of government or local authority action or restriction.

In the context of one particular policy wording, the court found that anything short of complete closure by a

public authority would not constitute “prevention of access”. The judges distinguished this with the phrase “hindrance of access” by stating that “hindering” meant “interposing obstacles which it would be really difficult to overcome” but would not be impossible.

Impact on restaurants, pubs and essential shops

In their judgment, the judges gave consideration to the impact of public health measures on restaurants, pubs and essential shops.

The court examined cases where restaurants and pubs were no longer allowed to serve customers on their premises. Having regard to the particular policy wording in question, the judges drew a distinction between businesses which had takeaway business prior to the COVID-19 crisis and those which had not. The closure of businesses without a pre-existing takeaway service was found to be a qualifying “prevention of access” for purposes of the business-interruption clause, even where a new takeaway service was established, since that newly established takeaway business would likely be fundamentally different from the sit-down dining/pub business described in the policy schedule.

However, the court noted that, if the business had a substantial existing takeaway service which it continued to operate from the premises, then there was no “prevention of access”, as the business could continue to operate its pre-crisis takeaway service, albeit that its sit-in dining service was not possible.

In the case of essential shops which were expressly allowed to remain open but voluntarily closed due to reduced footfall and public confidence, it was held that their businesses may have been impeded or “hindered”, but there was no “prevention of access” to their premises.

Conclusions

The English High Court’s judgment provides detailed guidance on this topical issue and, although it is not binding in this jurisdiction, it is indicative of how an Irish court might approach these issues. The judgment is likely to raise the hopes of many Irish businesses which are in dispute with their own business interruption insurers. It is important to be aware, however, that each case will turn on the particular wording of the relevant policy and the nature of the insured entity’s business and the effect which the COVID-19 crisis has had on that business.

More generally, the judgment illustrates the benefit for business owners of having a particularly pro-active regulator of the insurance industry. The FCA has managed to obtain judicial clarity on a number of key issues in the space of just over three months. Irrespective of any appeal, that should lead to the settlement of many outstanding business interruption claims against insurers. Whilst the Central Bank of Ireland has taken the commendable step of publishing its “COVID-19 and Business Interruption Supervisory Framework”, it has to date adopted a more passive approach than its counterpart across the Irish Sea.

The contents of the above article are for general information purposes only and do not constitute legal advice. If you have any queries regarding business interruption insurance, please contact Shane Neville (sneville@lkshields.ie) or Ian Lavelle (ilavelle@lkshields.ie).

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