The Supreme Court's Judgment in the Covid-19 Business Interruption Insurance Test Case Breaks New Ground on Causation and overturns the Orient Express

1. On Friday 15th January, the Supreme Court handed down its much anticipated Judgment in the FCA Test Case relating to Covid Business Insurance, The FCA v Arch & Others [2021] UKSC 1. This is undoubtedly one of the most significant decisions in insurance law in a long time – not just because it decides whether many policyholders have effective insurance cover for business interruptions due to national Covid-lockdowns but also because it revisits fundamental principles of causation in insurance law. In this article, Anna Hoffmann offers an overview and analysis of the key points emerging from this seminal case.
2. In summary, the Supreme Court allowed the appeals from the FCA (subject to some qualifications) and dismissed Insurers' appeals. Commercially, the most significant implication is that business interruption cover will be available for many policyholders. The Supreme Court estimates that around 370,000 policyholders could be directly affected by this case, and that their loss will not be reduced by Covid-related pre-trigger downturns in revenue. From a legal perspective, this case breaks new ground regarding causation. The Judgment overrules a long-standing key authority in insurance law: *Orient-Express Hotels Ltd v Assicurazioni Generali SpA (trading as Generali Global Risk) [2010] EWHC 1186 (Comm); [2010] Lloyd's Rep IR 531.* Perhaps these Lordships were best placed to do so, given that two of them had been involved in the *Orient Express* decision, Mr George Leggatt KC (as he then was) as a member of the arbitral tribunal and Hamblen J (as he then was) as the judge who decided the appeal in that case. They now conclude that the case relied on a wrong causation analysis.

Context

3. The international Covid-19 pandemic does not need an introduction. In March 2020, the UK Government decided to implement the first national "lockdown", *inter alia* closing non-essential businesses. It is in this context that the question arose whether certain clauses that were widely used in non-damage business interruption insurance extensions provided cover in this situation.
4. In order to settle this question in relation to a selected number of wordings, the Financial Conduct Authority (FCA) brought a Test Case under the Financial Market Test Case Scheme against the eight Defendant insurers. The FCA stood in these proceedings in the shoes of the policy-holders and represented their interests. Two consumer interest groups intervened in this case on the side of the FCA: the Hospitality Insurance Group Action and the Hiscox Action Group.
5. This note does not deal in detail with the individual wordings but focuses on the overarching principles applied by the Court. This Test Case, by its very nature, was concerned with matters of principle, such as causation and counterfactuals, rather than any specific set of facts. Even though there was an agreed set of facts, this was not the focus of the hearings, arguments or indeed Judgments.

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The Commercial Court Stage

6. Lord Justice Flaux and Mr Justice Butcher heard the case at first instance over 8 days from 20th July 2020. The hearing was held online and a live-stream was open to the public. The Judgment was handed down electronically on 15 September 2020 and can be found here.

The Types of Clauses

7. Flaux LJ and Butcher J categorized the various clauses into three categories: disease clauses, denial of access clauses and hybrid clauses. This categorization was adopted by the parties and the Supreme Court as well:
    1. Disease Clauses require an occurrence/manifestation of the relevant notifiable disease (and it was accepted that Covid-19 had become a notifiable disease on 6th March 2020 in the UK) within a certain radius (1m, 25 miles) of the insured premises. The FCA had indicated in its initial guidance to the Insurers that clauses requiring an occurrence of the disease on the premises were not part of the Test case. An example of a classic disease clause is RSA 3, which was discussed at [91ff] in the High Court Judgment.
    2. Denial of Access Clauses share the common feature that access to the premises needs to be hindered or prevented, usually through public authority action.
    3. Hybrid Clauses combine a disease occurrence requirement with denial of access, e.g. prevention of access through public authority action following occurrence of a notifiable disease within a certain radius.
8. The High Court Judgment provided mixed results for both sides with the Court finding that the Disease Clauses generally provided cover, whereas those denial of access and hybrid clauses requiring a local trigger (e.g. QBE 2 and 3) were deemed to not provide cover. The Court also made a number of findings which restricted availability of cover on denial of access (and hybrid) wordings, as well as holding that pre-trigger losses could in principle be taken into account as relevant trends when adjusting the loss.

Causation & Disease Clauses

9. The FCA advanced two alternative arguments on causation in relation to the disease clauses. They argued that either each instance of Covid-19 in the UK was a concurrent effective cause of the measures which led to the loss or that, alternatively, that there was one indivisible cause: the disease. Insurers disagreed with this and argued that the loss was not proximately caused by the individual case of Covid-19 and that the 'but for' test had to be satisfied for any cause to be a cause at all. As the loss would still have happened but for the occurrence of the local outbreak of Covid-19, the Insurers argued, there should be no cover.
10. Even though the submissions had focused a great deal on causation, the High Court Judgment resolved questions of causation quickly by focusing on construction. [100]
11. The nature of Notifiable Diseases, which also include SARS, as diseases "which are capable of widespread dissemination" [104] was an important factor for in the construction of the insured peril for Flaux LJ and Butcher J. Therefore, they concluded that these radius disease clauses provided *"cover for the effects of a disease which may occur both within and outside the specified radius, and which may trigger a response of the authorities and the public to the outbreak as a whole".* [110]
12. The Justices favoured the analysis that the individual outbreaks formed part of an indivisible whole but held that: *"Alternatively, although we regard this as being less satisfactory, each of the individual occurrences was a separate but effective cause."* [112]
13. The Insurers appealed that conclusion on the disease clauses.

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Hybrid & Denial of Access Clauses

14. The High Court held that "restrictions imposed" had to be mandatory legal restrictions "promulgated by a statutory instrument" [268]. Furthermore, it held that "inability to use" meant complete inability to use save for use that was *de minimis*. These points were appealed by the FCA.
15. The Court distinguished between those denial of access and hybrid wordings that required a local trigger, such as a local event to have caused the restrictions (QBE 2 and 3) and those clauses which required a general occurrence of the disease more akin to the radius disease clauses considered above. For the former, the High Court held that there was no cover whereas there was cover for the latter. The insurers and the FCA appealed those findings respectively.

Trends Clauses

16. An important aspect of the case centres on the trends clauses which are included in most of the policies under consideration. Essentially, these trends clauses state that some adjustment of the loss can be made in reference to trends which occurred before the insured peril was triggered. [1] The High Court held that these clauses also applied to the non-damage business insurance extensions *mutatis mutandis*. A key question before the High Court and also Supreme Court was what the correct counterfactual would be against which the loss should be compare. Particularly, whether the right comparative is a world in which certain restrictions had not occurred but there was still Covid-19, or whether the disease had to be stripped out completely from the counterfactual. This, of course, required consideration of the seminal case in this area: the *Orient Express*.
17. The High Court held that Covid-19 had to be taken out of the counterfactual as it was part of the insured peril [279] but that cover could only start from the moment that all elements of the composite peril (e.g., restrictions + disease + inability to use) were in place and the policy therefore "triggered". Therefore, pre-trigger downturns could be taken into account in the adjustments. This was a key point of discussion on appeal to the Supreme Court as this could arguably have meant that in a situation where a business had closed before mandatory restrictions had been in place, this downturn due to Covid-guidance, could have erased the recoverable loss.
18. Insurers had argued that the present case was analogous to *Orient Express* in that the insured peril was the damage / the business interruption and not the cause of the damage, i.e. the hurricane or in this case, the disease. Therefore, as in *Orient Express*, they argued, the disease had to be stripped out of the counterfactual. The High Court distinguished the Orient Express but also stated that they thought there had been a fallacy in the reasoning and that it would have declined to follow the case.

The Supreme Court Decision

19. On 15th January 2021, the Supreme Court handed down its Judgment. Lord Hamblen and Lord Leggatt gave the main Judgment with which Lord Reed agreed ("the Majority Judgment") and Lord Briggs gave a concurring Judgment with which Lord Hodge agreed ("the Minority Judgment").
20. The structure of the Judgment followed the main issues arising from the High Court decision, dealing principally with:
    1. The disease clauses – interpretation;
    2. The prevention of access and hybrid clauses – interpretation;
    3. Causation;
    4. The trends clauses;
    5. Pre-trigger losses; and
    6. The Orient Express decision.

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Disease Clauses & Concurrent Causation

21. The Majority Judgment reaches the same conclusion (there is cover) as the High Court decision but by a different route. The Justices held that in radius clauses the insured peril was not the disease generally or the outbreak of the disease but rather that *"as a matter of plain language, the clause covers only cases of illness resulting from COVID-19 that occur within the 25-mile radius specified in the clause".* [71]
22. They also rejected the distinction drawn by the High Court between "event" and "occurrence" and treated QBE 2 and 3 as the other disease clauses and concluded that QBE 2 and 3 had been correctly treated by the High Court and that the other disease clauses fell under the same logic and did not cover occurrences of the disease outside the relevant radius. [94] Lord Briggs, in the Minority Judgment gave a concurring separate Judgment which reaches the same conclusion but would not have departed from the High Court's analysis that both analyses (concurrent causation as well as single indivisible cause) were available. [2] [321]
23. This interpretation of the clause language brought causation firmly back to centre stage. [161] The Majority Judgment dedicates detailed passages to Proximate, Concurrent Causation and But For Causation. The key points that emerge are:
    1. The starting point is the Marine Insurance Act 1906 where the concept of "proximate cause" was first developed. However, this concept has been developed and the notion of an "efficient cause" became increasingly common with an emphasis on common sense. [167]
    2. The Lordships emphasised: *"It is not a matter of choosing a cause as proximate on the basis of an unguided gut feeling. The starting point for the inquiry is to identify, by interpreting the policy and considering the evidence, whether a peril covered by the policy had any causal involvement in the loss and, if so, whether a peril excluded or excepted from the scope of the cover also had any such involvement. The question whether the occurrence of such a peril was in either case the proximate (or "efficient") cause of the loss involves making a judgment as to whether it made the loss inevitable – if not, which could seldom if ever be said, in all conceivable circumstances – then in the ordinary course of events."* [168]
    3. The Lordships then discuss the modern law relating to concurrent causation and concluded that: *"There is, in our view, no reason in principle why such an analysis cannot be applied to multiple causes which act in combination to bring about a loss. Thus, in the present case it obviously could not be said that any individual case of illness resulting from COVID-19, on its own, caused the UK Government to introduce restrictions which led directly to business interruption. However, as the court below found, the Government measures were taken in response to information about all the cases of COVID-19 in the country as a whole. We agree with the court below that it is realistic to analyse this situation as one in which "all the cases were equal causes of the imposition of national measures"* (para 112). [176], also [191]
    4. Furthermore, the Majority Judgment concludes that in order to establish causation in this context, the 'but for' test is neither adequate nor necessary. "*The most conspicuous weakness of the "but for" test is not that it wrongly excludes cases in which there is a causal link, but that it fails to exclude a great many cases in which X would not be regarded as an effective or proximate cause of Y."* [181]
    5. Importantly, for concurrent causation to apply the causes need to be of "approximately equal efficacy". Thus where, for example a business has a denial of access clause but lost almost all its business as a result of the travel restrictions and this was deemed to be the sole proximate cause of loss of its walk-in business, then there would be no cover. [244]
    6. It is also noteworthy that the Court did rely on IF P & C Insurance Ltd v Silversea Cruises Ltd [2003] EWHC 473 (Comm); [2004] Lloyd's Rep IR 217 to bolster its argument on concurrent causation. The Majority Judgment refers to it as offering an analogy and support for its conclusions on pre-trigger losses and wider causation analysis [241-242].

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Denial of Access & Hybrid Clauses

24. The above causal analysis also applies to hybrid clauses which contain, as one element, an occurrence of an infectious disease within a specified distance of the insured premise: "*In order to show that business interruption loss is covered by this clause, it will be sufficient to prove that the interruption was a result of closure or restrictions placed on the premises in response to cases of COVID-19 which included at least one case manifesting itself within a radius of 25 miles of the premises."* [213]
25. A point on appeal was whether the restrictions had to have the force of law. The Majority Judgment disagreed with the conclusion reached by the High Court and held that "*When the Prime Minister in his statement of 20 March 2020 instructed named businesses to close "tonight", that was a clear, mandatory instruction given on behalf of the UK Government".* [120] However, this depended on the specific circumstances of the restriction and only in limited circumstances would "restrictions imposed" not mean something equivalent to mandatory.
26. The Majority Judgment also recognises that an "inability to use" has to be read as an "inability to use the premises for the purposes of the business" and recognises that there may be a partial inability depending on different business purposes, e.g. a restaurant that can still use the kitchen for take away orders but cannot use the restaurant space to seat and serve customers. The Majority Judgment expressly acknowledges: *"We consider that the requirement is satisfied either if the policyholder is unable to use the premises for a discrete part of its business activities or if it is unable to use a discrete part of its premises for its business activities."* [137] The same logic was extended by the Court to "prevention of access wordings". As long as there was a complete prevention of access to a part of the premises or for a discreet purpose, this part of the clause will be satisfied. [151] Similarly, the Court concluded that an interruption could also be partial and did not require complete cessation. [158] This extends the pool of policy holders who may be able to claim under such a clause significantly.

Trends Clauses & Pre-trigger Losses

27. In order to identify the insured peril in these composite clauses and also in order to identify the correct counterfactual, the Majority Judgment rejects the reasoning of both sides and criticises an undue focus on But For Causation [228]. The Justices held that the loss was "overdetermined" and stated: *"We have already expressed our view that it would undermine the commercial purpose of the cover to treat such potential effects as diminishing the scope of the indemnity. The underlying reason, as it seems to us, is that, although not themselves covered by the insurance, such effects are matters arising from the same original fortuity which the parties to the insurance would naturally expect to occur concurrently with the insured peril. They are not in that sense a separate and distinct risk*." [237]
28. The Court also recognised that the trends clauses were not there to delineate the scope of the indemnity [260] and that they should be construed consistently with the insuring clauses [261] and "*if possible, they should be construed so as not to take away the cover provided by the insuring clauses. To do so would effectively transform quantification machinery into a form of exclusion."* [262] The Majority Judgment holds that *"the aim of such clauses is to arrive at the results that would have been achieved but for the insured peril and circumstances arising out of the same underlying or originating cause".* [268]
29. That reasoning also informed the Court's reasoning on pre-trigger losses as already set out above. Accordingly, the Court overruled the *Orient Express*, stating that: *"In the present case the court below considered that the Orient-Express decision was distinguishable but, if necessary, would have reached the conclusion that it was wrongly decided and would have declined to follow it. For reasons already given in addressing the causation and trends clauses issues, on mature and considered reflection we also consider that it was wrongly decided and conclude that it should be overruled." [308]*
30. It was said that the main error had occurred when considering causation under the insuring clause where it had applied a But For Causation test when a concurrent causal analysis would have been more appropriate, i.e. that the loss had been caused by the concurrent causes of damage to the hotel and damage to wider parts of the city

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of New Orleans.

Analysis

31. This Judgment represents a significant new development in the area of causation in insurance law. Especially the *dicta* regarding Concurrent, Proximate and But For Causation and the overruling of *Orient Express* will have implications far beyond this Test Case. It will be interesting to see to what extent the notion that there can be a very large number of concurrent effective causes can exist will be relevant in future cases or whether this will be more confined to the specific factual background to this case. The logic could for example also be relevant to a context of a cyber virus and not a natural virus.
32. Crucially, the *dicta* on trends clauses and pre-trigger losses will have a significant impact on loss-adjusting. The Court has made clear that pre-trigger losses due to the "same original fortuity" would not constitute a distinct separate trend to take into account. This changes what can be taken into account significantly, e.g. the loss caused by people staying at home due to Covid-fears before the lockdown guidance or regulations came into effect could not be taken into account to adjust the loss downwards.
33. Similarly, the conclusion reached that partial prevention of access / inability to use satisfy the relevant wordings widens the availability of cover significantly and requires a careful analysis during loss adjusting of what part of the business could be carried on and which could not.
34. Much will depend on the specific facts of each case in order to asses whether a loss was truly caused by concurrent causes of "approximately equal efficacy". There surely will be much litigation dealing with specific sets of facts and how these general principles should be applied. What is certain is that this Judgment has shaken up the established view on causation and trends clauses in insurance law.
35. 4 Pump Court's Rachel Ansell KC and Martyn Naylor acted for QBE UK Ltd.

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[1] An example (RSA 3 adjusted for non-damage extension): "adjustments shall be made as may be necessary to provide for the trend of the Business and for variations in or other circumstances affecting the Business either before or after the occurrence of the insured peril or which would have affected the Business had the insured peril not occurred so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results which but for the insured peril would have been obtained during the relative period after the occurrence of the insured peril".

[2] The only other point on which the Minority Judgment diverges is that Lord Briggs states that defence costs cases are best seen as sui generis and not of a general application. [326]

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