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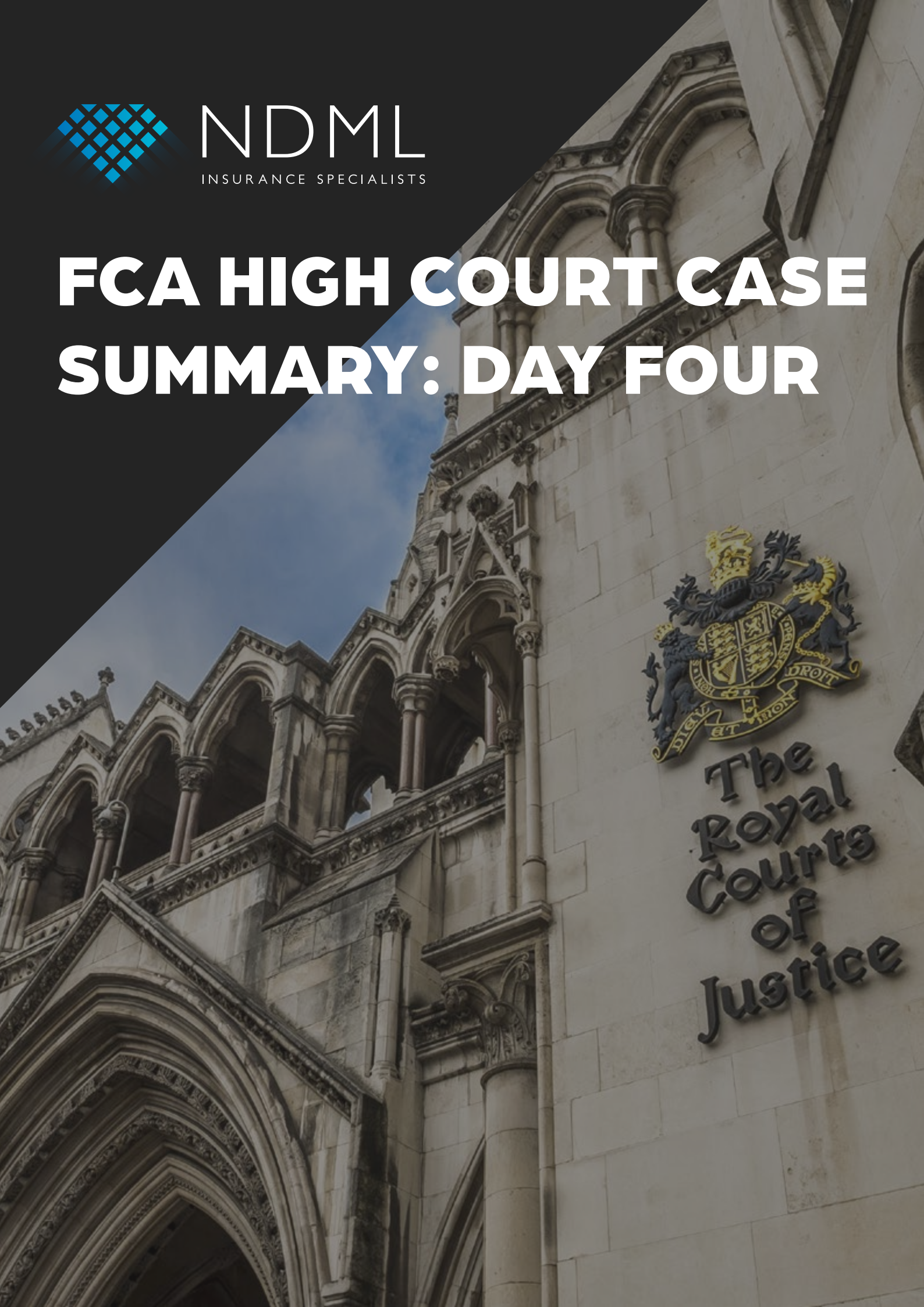
INSURANCE SPECIALISTS

FCA HIGH COURT CASE SUMMARY: DAY FOUR



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Day Four began with submissions from a Mr Lynch, who sought to address the Public Authority clause in the Hiscox policy. He asserted that the terms used within the Hiscox policy could and should be interpreted with a broad meaning as opposed to the very narrow definitions asserted by the insurers. He pointed out that 'restrictions imposed by a public authority' could mean both the direct closure of premises using the force of law as well as the more general statements issued by the Prime Minister regarding social distancing and lockdown. Mr Lynch sought support for his assertion from a previous case law involving AIG and the Solicitor's Regulation Authority, wherein it was ruled that the right approach to interpretation of terms was to allow them their 'natural meaning':

> *"It is not a question of reformulating the clause, it is an exercise of judgment, not a reformulation of the clause to be construed and applied".*

Furthermore in the case law of Earl of Lonsdale v Attorney General [1982] Mr Justice Slade pronounced:

> *"Of many, perhaps the majority, of the words used by English speaking people there can be little doubt as to the ordinary meaning, or 'literal' or 'primary' meaning, as it is often called. To take an example at random, the court would not, I conceive find much difficulty in attaching a literal or primary meaning to the word 'elephant', if it found it in a written instrument. In contrast, however, some English words and phrases fall into a second, quite different category. They are words and phrases which are readily capable of bearing two or more alternative meanings and to which the court is not willing to ascribe a prima facie meaning, so as to impose upon any party the onus of displacing it. In any such case the court finds itself obliged to construe the word in its particular context, having regard to the admissible evidence, without any predisposition to give it one meaning in reference to another."*

In essence Mr Lynch sought to enjoin the court in allowing a broad but nonetheless context-specific interpretation of the key terms within the policy, not least because Hiscox were more than capable of narrowing their wording had they so wished. Indeed, Hiscox's own preamble to their policy states:

> *"Thank you for choosing Hiscox to protect your business. We hope the language and layout of this policy wording are clear because we want you to understand the insurance we provide, as well as the responsibilities we have to each other."*

The implication must therefore be that the Hiscox wording strives for clarity. As such, any post-loss interpretation by their underwriters that modifies or narrows certain terms that are easily capable of having broad definitions is palpably unfair.

Mr Lynch also pointed out that Hiscox's assertion about the area in which one should interpret a general 'occurrence' having happened seeks, counter-intuitively, to reduce the possible catchment area for a disease to less than those policies that feature (for example) a 1-mile radius condition. Essentially this means that in having a policy with no geographical restrictions you actually have more restrictions (if one takes Hiscox's view) than a policy that does enforce a boundary limit.

Mr Lynch also addressed the issue, previously considered by Mr Edelman, as to whether one should take the 'pre-loss' downturn into account when calculating the 'post-loss' Business Interruption claim. Mr Lynch took the example of a café that experienced an ingress of sewage from the drains – this café would not continue to stay open until such time as the council came along to shut it down, even though the Hiscox Public Authority extension requires this kind of action for a claim to be considered.

As such, they might shut down on Monday, with the council only arriving on Wednesday to formally apply a prohibition notice. Mr Lynch argued that it would be unreasonable for the insurers in that scenario to calculate the loss based on Monday and Tuesday's turnover and therefore conclude that the client did not have any loss. However this seems to be what Hiscox and other insurers are seeking to argue in relation to the COVID-19 pandemic.

THE DEFENCE

Following Mr Lynch's representations the hearing turned to the defences from each insurer's representatives. The first to submit their case was Mr Kealey who, whilst engaged on behalf of Ecclesiastical and MS Amlin, had been selected to provide oral submissions for the benefit of all insurers on the fundamental principles of the case.

Mr Kealey began by asserting that the FCA are seeking to apply one indivisible peril as a trigger for all the policy wordings being considered. However Mr Kealey insisted that, in fact, not one policy contains a wording that matches directly this single peril articulated by the FCA. For avoidance of doubt, this peril was described as:

> *"The (nationwide) COVID-19 disease, including its local presence or manifestation, and the restrictions due to an emergency, danger or threat to life due to the harm potentially caused by the disease".*

Or, as listed elsewhere:

> *"The single proximate cause is the disease everywhere and the government and human responses to it".*

Mr Kealey asserted that the policies in question made no reference to 'human responses' to the disease.

Mr Kealey then addressed the issue of counterfactuals and how one should conceive of these scenarios. In his view, the FCA counterfactual (ie. imagining a world without COVID-19) can not be supported by the wording of the policy and indeed at some point a line has to be drawn within any counterfactual between the trigger for the policy and the actual, real-world circumstances giving rise to the claim.

Mr Kealey quoted the case law of *Sartex Quilts & Textiles v Endurance Corporate Capital Ltd* wherein Lord Justice Leggatt asserted that:

> *"In a case where an insurer has agreed to indemnify the insured against loss or damage caused by an insured peril, the nature of the insurer's promise is that the insured will not suffer the specified loss or damage. The occurrence of such loss or damage is therefore a breach of contract which gives rise to a claim for damages...The general object of an award of damages for breach of contract is to put the claimant in the same position so far as money could do it as if the breach had not occurred."*

In his view, Mr Kealey felt that this ruling implied that an insurance policy's correct response is in assessing losses 'but for' the breach (ie. the restrictions on/closure of the premises). In this way Mr Kealey sought to limit the insurer response to the policy trigger and to constrain the counterfactual used in calculating a policyholder's losses.

Mr Kealey was pressed by the judges on this point and he elaborated as below:

> *"The question that is asked under an insurance contract, which is absolutely vital and it seems to be not the question that the FCA has asked itself, is whether the insured peril has caused the claimed loss? Because when you are in a bilateral contract, assuming a contract of insurance is bilateral for present purposes, the only question that arises for any tribunal, and indeed for the contracting parties, is : firstly, has there been an insured peril; and secondly, has that insured peril caused the claimed loss? If there is another cause of that loss, which let us call it at the moment of equivalent weight, if that loss would have occurred but for the insured peril , then by definition the insured peril has not satisfied the threshold "but for" test for the purposes of that insurance policy".*

In essence Mr Kealey sought to suggest that the losses experienced by a policyholder would have happened anyway, regardless of the 'insured peril' (ie. the enforced closure of their business).

Mr Kealey's argument continued on the basis that UK insurance law is unusual in that any occurrence of an insured peril effectively puts the insurer in breach of contract. In short, the insurer 'promises' to hold the policyholder 'harmless' for the period of the contract – but when harm does occur this therefore means that they are in breach of said contract. This assertion was supported by the case law of *Chandris v Argo and Ventouris v Mountain*.

A lengthy discussion was undertaken regarding a scenario wherein there could be two independent causes, one of which being insured and the other not insured, and wherein the cause that is not insured could be viewed as the 'true' (proximate) cause of the loss. The example was given about a train track wherein a storm causes a landslip to cover the line (a peril that is insured), but at the same time causes signalling failure on the track (where signal failure is not covered by the policy). Mr Kealey asserted that it would appear initially that the landslip had been the 'proximate' cause of the train not being able to run – however in fact regardless of the landslip having occurred the train would not have run due to an event not insured by the policy. As such, he argued, the policy would not respond in that scenario.

Mr Justice Butcher questioned Mr Kealey as to whether the obligation rested with the insurer to prove the differentiation in causes. Mr Kealey did not answer the question directly and sought to move onto other points. However Lord Justice Flaux interjected that the burden must be on the insurer to disprove what might have initially appeared to be the cause of the loss. Mr Kealey then sought to agree with Lord Justice Flaux, albeit with a caveat that, were the insurers to bring some evidence to bear of an alternative cause for the loss then the evidential proof would shift back to the policyholder.

The above would seem to be crucial in assessing what the 'claimable' loss might be for a client after lockdown – ie. does one keep COVID-19 in one's consideration, or does one remove it entirely from the counterfactual? The insurers will be able to point to COVID-19 as a significant cause of downturns in turnover across industry sectors and therefore Mr Kealey's argument is that the evidential burden shifts to the policyholder to prove what effect the lockdown had on their business.

Mr Kealey then turned his attention to what scenarios should be 'reversed' (ie. removed) from the counterfactual used to assess a client's losses. In his view the only thing that can be removed is the insured peril, and furthermore the insured peril as it has been built up by its constituent elements. Mr Kealey used the example of 'vermin at the premises' – a business has rats, the local newspaper

gets wind of the same and the local authority steps in to close the premises while the rats are exterminated. In his view the insured peril is *"closure of the premises as caused by government action, as caused by rats"*. You do not remove the 'rats' on their own, you remove the combination and then work out what the loss would be as a result of this insured peril. If the presence of rats has also caused a disinclination of the public to attend the premises this is a separate, uninsured causal connection and in his view should not be factored into the earlier scenario.

Continuing this example, Mr Kealey asserted that in a situation whereby the café had only been operating at 50% capacity before its closure because of the suspicion of rats on the premises, after the closure the café would only have been able to claim 50% of its losses. However he also went further to suggest that the 50% operation of the business pre-closure was likely to have been part of a continuing downward trend that was simply arrested by the closure.

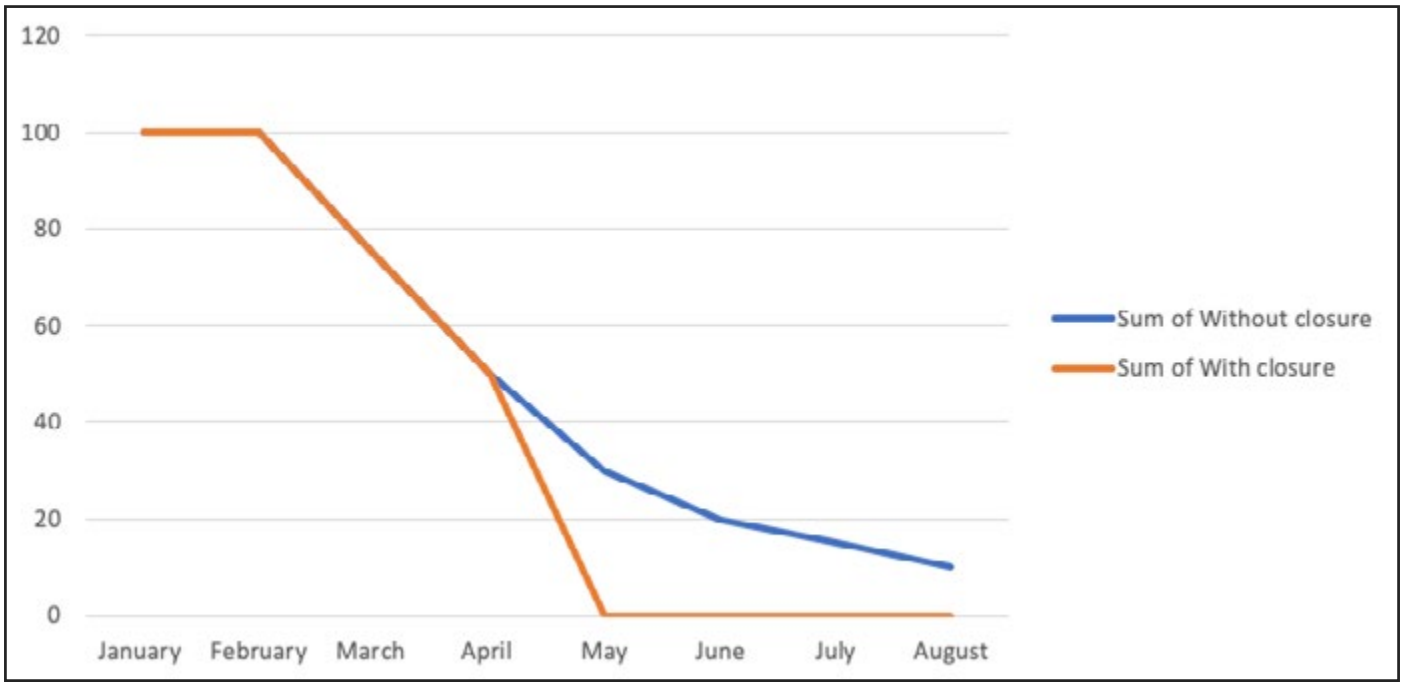

Figure 1 – Would turnover have continued to reduce even if a business had not closed?

In the above graph the business closed in May, but was already on a downturn because of an external circumstance not covered by the policy. In Mr Kealey's example, this 'external circumstance' is the presence of rats – if the business had not been closed by the council the turnover would have reduced regardless. As such, in his view it would be unreasonable to calculate the business losses based on a 'no-rat' period. Mapping this on to the COVID-19 situation, Mr Kealey suggested that people were already social distancing and staying at home prior to lockdown and that this trend would only have continued even if the hospitality sector had not been forced to close. As such, the consideration of losses is based on the below (following page):

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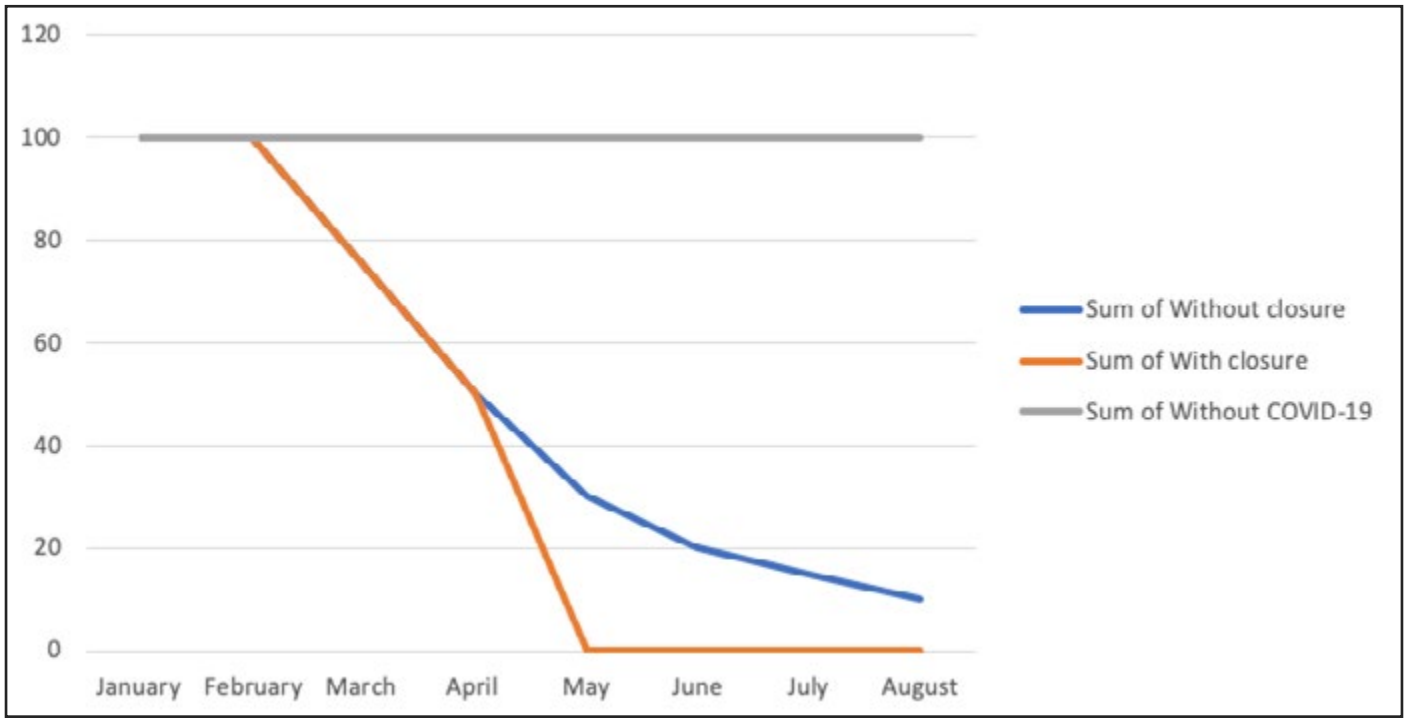

Figure 2 – Turnover with closure, turnover without closure and turnover without COVID-19

Mr Edelman had previously suggested that one should extract COVID-19 from a counterfactual assessment of a client's post-lockdown loss (the grey line). However Mr Kealey's assertion is that instead one has to follow the blue line to get the correct calculation of loss.

Mr Kealey then sought to address the issue of the 25-mile radius applicable to certain policies. He posited that, even if a person can be proved to have had COVID-19 24 miles from a business premises that is not sufficient to invoke coverage under the policy. In Mr Kealey's view, it was not due to the single instance at a radius of 24 miles that the business was closed – it was closed because the disease was nationwide.

Furthermore, Mr Kealey pointed out that the application of a 25-mile radius was clear evidence of the insurers seeking to limit their exposure to loss. If they had wished to cover pandemics, Mr Kealey advised that they could have done so. Instead however the insurers have placed a limit on the geographical area in which they will respond, which in turn expresses their intention to cover relatively localised outbreaks of disease such as measles etc *but not nationwide epidemics*.

Based on the above assertion, Lord Justice Flaux concluded that there may be coverage available for businesses within the Leicester area because they have been locked down by government action solely because of cases within a 25-mile radius.

Mr Kealey insisted that, in attempting to 'reverse out' the COVID-19 pandemic from the applicable counterfactual, the FCA were guilty of rewriting the policy contract and holding the insurance companies to a peril that they had not intended to insure.

Mr Kealey advanced the argument that coverage would apply if it could be proven that an instance of disease within a 25-mile radius from a business had directly contributed to the lockdown. In that scenario, the prevalence of COVID-19 outside the radial limit would be immaterial as the instance of

the disease within the delineated area had been the proximate cause of the closure of the business. However Mr Kealey was keen to point out that an instance of COVID-19 within the 25-mile radius that is merely a single example of many across the country should not be allowed to be a 'gateway' to broader coverage than was part of the original contract. This latter scenario, in his view, removes the 'causative principle' from the coverage, saying in effect that, as long as there is at least one instance of COVID-19 within a 25-mile radius, a client is entitled to pandemic coverage.

Mr Kealey then addressed the key *Orient Express* case and how he believed that it should be interpreted. By his assertion, that case made clear that the insured peril under the Business Interruption section was the 'damage' sustained *not the hurricane itself*. Effectively this divorces the operating event that *caused* the damage from the loss of turnover that stemmed from said damage. This avenue of argument seems pertinent in comparison to the previous assertions of the FCA barrister, Mr Edelman, wherein he suggested that the background situation of COVID-19 would have to be removed as *well* from any counterfactual, thus producing a calculation of loss based on an imagined world in which the coronavirus did not exist. However Mr Kealey's suggestion seemed to be that only the direct trigger of a policyholder's Business Interruption cover (ie. the closure of the premises) should be removed from any counterfactual assessment of loss.

It was clear that Mr Kealey was focussed on asserting the correctness of the *Orient Express* case and much of his argument was spent in addressing the arguments and rulings within the same. These can be summed up by his statement that:

> *"[In the Orient Express case] it was necessary to assess the BI loss on the basis that the hotel was undamaged but nothing else was different. In other words, but for the damage to the hotel. In other words, but for the insured peril. No more and no less".*

Mr Kealey sought, perhaps oddly, to suggest that there is a hierarchy of covers, with material damage as the primary part, Business Interruption as a 'parasitic' follow-on from this cover, followed by additional non-damage extensions which are 'relatively circumscribed'. Mr Kealey then suggested that these extensions are circumscribed precisely because they are 'add-ons', describing them as *"not a gift but...of benefit to the insured".*

Mr Kealey concluded by suggesting that the FCA barristers were:

> *"Essentially throwing out the basic and fundamental concepts of factual causation under English law".*

He also asserted that their reasoning was:

> *"Wholly unacceptable. It is anarchic in legal terms and fundamentally wrong".*

Mr Turner then took over the defence submissions and reiterated that, in his view, the FCA's stance reduces the proximity requirement to a non-causal contingency. He suggested that a contract built to respond in this way would be merely, in his words, an *"aleatory bargain, something turning on the roll of a dice".*

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Mr Justice Flaux seemed supportive of Mr Turner's arguments, especially in relation to the application of geographical limits to the coverage provided. In his view:

> *"If the cover is as broad as the FCA asserts, then the 1-mile or 25-mile vicinity requirement is completely pointless".*

Mr Turner also took issue with the FCA's insistence that 'manifestation', where mentioned within policies as a trigger for coverage, is synonymous with 'occurrence'. In Mr Turner's view, manifestation must be tied directly to a confirmed presence of COVID-19, which in turn therefore leads to a closure of the premises. If this is not the case, Mr Turner asserted, one would be forced to insist that an unknown episode of COVID-19 had given rise to the closure of a business. In his view, this would be untenable as an argument.

You can follow the case live by visiting the FCA website, or by clicking here.

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