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Pollyanna Deane's Insurance Column: August 2020

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In her column for August 2020, Pollyanna considers the FCA's High Court test case seeking legal clarity on the meaning and effect of certain business interruption (BI) insurance policy wordings related to the COVID-19 pandemic.

Test Case Special

I submitted my last column to Practical Law the day before the FCA published their particulars of claim. It meant that I was still expressing the hope that the FCA would behave as a regulator rather than a cheerleader for the policyholders. The particulars of claim however rather disabuse this notion. I was pretty surprised at the tone it took, shouting loudly as it were, with reference to "absurdity" on the bits that relied on non sequiturs and essentially blustering when discussing the weakest parts of the case. I'm no litigator but this isn't a knockabout piece of litigation we are faced with. The statistics speak for themselves:

- 1, maybe 2 regulators.
- 8 defendant insurers.
- 2 action groups.
- 48 other directly affected insurers with 300 basic policy wordings, many drafted by leading brokers.
- 2 judges.
- 29 barristers.
- 8 days for the court hearing.

... and a heap of paper referred to somewhat ruefully by Flaux LJ on the first day's hearing. The court timetable is also interesting. The FCA get three days, after which the defendants get between one and four hours each with the action groups' counsel also being heard. The FCA then gets another day and the action groups get a few more minutes. Although we might have hoped the insurers had made submissions on different matters so that all is covered (which they did in terms of causation where Kealey QC made the main submission), in fact they by and large tended to make their own points, meaning the time pressure as far as I can tell from the transcript but as to be expected, became almost unbearable.

The FCA is deliberately arguing this case from the policyholders' point of view, rather than as a prosecutor – this is somewhat different from the initial statements about the approach it would take. This has the problem that the policyholders' view will appear to be reinforced (by the FCA). The policyholders will be reassured by this in thinking that they are right and thanks to the FCA, insurers are left to look after themselves. While the aim is admirable, to settle as many issues as possible so that as many claims as possible can be paid, the FCA's approach may well come back to haunt them. The FCA has long been championing clear, fair and not misleading policy wording. In their view, plain language is to be lauded and applied and ambiguous language is subject to an objective test. They take the view that insurers accept not just the specific risk, but also the risk that circumstances, facts and law may change. Therefore, insurers should be aware of pandemics and their consequences, according to the FCA.

There is a danger that the FCA is sitting in an ivory tower here. Especially as they view government action, advice and guidance from February and March as monolithic and government advice as regulation. Even if that's not true, the FCA refer to a meeting with the Chancellor on 17 March and the insurance industry agreeing to act as if this was the case. It is striking how many of the defendant insurers weren't at the meeting and do not agree. Five of them state that it is not appropriate for a meeting with the Chancellor to amend the terms of a private contract. The FCA rows back a little from this point at section 12.3 of its reply.

When the FCA looks at the wordings of the policies, it takes the view that the terms (which require a policy to respond when a particular kind of authority acts in a particular way) can be overridden by the collective force of the actions taken. The FCA assumes the policies will respond and shoehorns the actual actions taken into the words used by the policies. Zurich, in its defence, calls this out commenting that the FCA takes an atomised approach to the wordings, not reading them in context, which is plainly wrong.

The defences look at the matter entirely in terms of construction and causation. They consider the actual terms of the policies, addressing issues of "prevention of access", hindrance of and restrictions to access to premises and what business interruption (BI) means. When considering the incidence of the virus, terms such as "in the vicinity" do not require insureds to make any effort to prove the existence of the disease. The issues connected to this include a discussion of the Scilly Isles (the islands are more than 25 miles away from the mainland and no cases of COVID-19 have been found). So whether a policy will respond if a business in the Scillies is closed, when the nearest case doesn't satisfy the terms of the policy. The defendants generally rely on the work of RSA to challenge the broad-brush approach taken by the FCA on these matters. The FCA's approach is that government action (broadly interpreted) making things more difficult, will apply to cover all those with a BI policy, regardless of whether they actually had to close their business or not. Interruption and its meaning, in particular whether the business had to stop, or whether social distancing measures which made access more difficult can be seen as interruption are swept aside in the general enthusiasm of the FCA to, in my view, create coverage where none would ordinarily exist. According to the FCA argument, for example, Hiscox's interpretation of the term "incident" doesn't mean a sudden, unexpected event, despite the wordings of the policies and Hiscox sternly stating in its defence what that means. The FCA is determined to create cover for all.

Their suggestion that the occurrence of a pandemic was not mentioned as it would be automatically included and could have been excluded specifically makes no sense; particularly in the light of particular exclusions or because the insured peril required a local incident leading to closure of business or prevention of access to premises. The FCA using a sleight of hand in its argument and approach is problematic, not least in its interpretation of the policy wordings.

By ignoring the actual wording of the policy, the FCA drives a coach and horses through the last 400 years of insurance law. They need to remember that they are not simply a force for the protection of policyholders (there is the Consumers' Association and the Financial Ombudsman Service (FOS) for that), but charged with market responsibility too. Seemingly subconsciously unaware of this, they refer to the majority of policyholders as small and medium sized enterprises (SMEs) and therefore as close to retail customers as it gets. They also mention the limits of cover being around £25,000, on the basis that these are quite small numbers, although as counsel for the Ecclesiastical points out, the even smaller limit of £10,000 will be sufficient to meet the amounts taken on the collection plate. Some defendants point out in their defence that almost all the policies were sold through brokers and the size of business is irrelevant – normal contract law applies.

There is clearly an unspoken fear among the broking community that they will be on the hook for misselling policies. In fact, the obvious fear and one also mentioned by the FCA, is that the FOS takes too close an interest, particularly as they are not necessarily known for making their decisions based strictly on the law! The parties to the case therefore note that they hope the judgments will be persuasive. I see that there is reference in the FCA's reply where they observe that most of the policyholders come within the jurisdiction of the FOS, which might be part of their argument concentrating on the small size of the defendants and the small size of the underwriting limits. Their "clear, fair and not misleading" mantra for policies and policyholder communication doesn't mean that they should be able to overturn the wording of policies just because they feel like it.

The FCA appeared, in its particulars of claim and reply to be keen to avoid having any real discussion on the lines of authority and insurance caselaw background. For example, see section 40 of the FCA's reply, rejecting reliance on *Orient Express Hotels Ltd v Assicurazioni Generali SPA t/a Generali Global Risk [2010] EWHC 1186 (Comm*) (a case which supports the defendants' view on the correctness of their decisions not to pay out). The transcripts of the case suggest that the court is having none of this and is engaging in robust discussion on the merits of this case, both with the FCA and with the defendants' counsel, seeking alternatives for the authority and other decisions in support. While the test case itself suggests that the FCA may seek to distinguish or overturn the decision in Orient Express, it is at least a case that has been decided, can be treated as precedent, it supports the insurance market and the insurers will be entitled to rely upon it. If the court does not follow the Orient Express case, they can expect the decision to be appealed. If the court does follow the case, we can expect the FCA to appeal. If the case is distinguished (perhaps on the basis of it affecting

damage cover only) the insurers will find themselves in a halfway house, with non-damage claims potentially being valid under the policies. However, while there has been considerable discussion over the correctness of the decision, if the FCA succeeds in overturning the decision in Orient Express, it will have a potential prudential impact on the insurance industry. We are sure that the PRA is keeping a close eye on this. The Insurer had an article headline on 28 July 2020 which stated "if the FCA succeeds, insolvencies could loom large on the horizon". It criticises the regulator for assuming the role of policyholder advocate rather than concentrating on its role in safeguarding the market.

So far, my review of the test case transcripts has thrown up some interesting points. At first, on a cursory review, I feared that the judges were taking too lenient a line with counsel for the FCA. The FCA's counsel were being allowed to speak for lengthy periods, with the judges not challenging them in the same way as they did when the counsel for the defence appeared and adhering to their arguments, even rather jokingly taking on board points being made by Edelman QC as "Edelman points" not being based in law, while being quite aggressive (well, for judges) in their questioning of the counsel for the defendants. I acknowledge that working from transcripts is difficult in that it is hard to spot where big points are made, as you have none of the normal clues from body language, expression, tone etc. Happily, in terms of purely reading the words, the defendants' counsel are more than up to the task of rebutting and identifying points, but the inequalities in the timetable are obvious with the defendants' counsel referring extensively to their skeleton arguments and being unable to expound some of the points more effectively. Note that Mark Howard QC on behalf of QBE elegantly suggests when referring to the FCA skeleton, something more: "the FCA's -- I was going to say skeleton, I think that would be a misuse of language, it is written argument".

Kealey QC, on behalf of Ecclesiastical and MS Amlin, submits the most detailed argument on causation from the defendants' side and enters into lengthy discussions with the judges, while Howard QC deals clearly and concisely with the construction arguments. It is instructive that his appearance is far less interrupted than Kealey's, but then, I wonder whether the whole case is going to boil down to causation. Certainly, the stress being laid on the judges needing to decide the case according to principles of law, rather than as would normally be the case, looking at individual facts, means that principles of causation are front and centre of the court's mind. This is perhaps helpful to all, given that I had feared that the judgment might be inclined to go through the policies one by one and determine whether or not and how each one should respond. The court has allocated to itself the more difficult task of determining the principles applicable to all.

Further, the arguments for construction and in particular the case which Howard QC puts are seemingly accepted by the judges (although bearing in mind, he is the penultimate counsel to appear for the defendants, the court might be feeling a little jaded). From all these advocates, there is clearly a frustration with the FCA essentially using an incidence of COVID-19 in the area as a qualifying condition to cover, rather than a cause of the loss, and there is clearly a suggestion that the FCA is trying to shoehorn the BI cases into the broader considerations of the mesothelioma cases, where the courts reflected a policy decision to grant cover to those who would otherwise have had nothing.

The approach taken by the FCA is the subject of some comment and surprise, as Howard QC puts it:

"insurance is not a game of lotto. An argument that, on its true construction, the liability of the insurer and the entitlement of the insureds depends on such chance is, to put it at its lowest, surprising. It is even more surprising, frankly, to find such an argument being articulated by the FCA, which normally wears a hat as the regulator of insurers, but perhaps, my Lords, the less said about that the better".

And there we have it, the FCA is overstepping the mark – its latest declaration on Monday 3 August suggested that insurers might not take into account the government assistance that businesses have had access to, in determining the loss payable under a valid claim (see Legal update, COVID-19: FCA statement on non-damage BI settlements and deductions relating to government support). When the basis of such insurance is indemnity, it is hard not to see this as creating a windfall for insureds and I always thought that it was important to put a policyholder back in the same position, rather than enabling it to make a profit from the insurer.

There is little more to say other than to speculate how the court will decide. The creativity of the arguments on behalf of the FCA were impressive, but the judges observed this and had some sympathy with the defendants following the law. The judges will be aware of the need to follow existing authority and not invent convenient principles to get to the result that they want and indeed, while we know what the FCA and the insurance market want, it is not clear from the judges' interventions that they have an agenda. They are not necessarily all Lord Denning! My initial impression was that the FCA would be supported, but the more that I read of the transcript, the less certain I am that that will be the case, and the clear unfairness of the timetable

working in their favour, provides some sense that the court will seek to restore the balance. The judgment is expected in mid-September.

For more information about the case, see Practice note, COVID-19: FCA business interruption insurance test case.