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Pollyanna Deane's insurance column: September 2020

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

Business interruption (BI) insurance and the FCA's potential own goal

Unless you've been living under a stone, you will all be aware of the test case that the FCA brought: an action against eight insurers, who issued policies covering BI insurance with a view to creating certainty as to when and if claims would be paid by the market in the light of the impact of COVID-19. I considered the test case in my August 2020 column.

Judgment at first instance, by Flaux LJ and Butler J, was handed down on 15 September. Sadly, it's not a clear, concise judgment, it's not written in the normal way, being a bit of an argument, a bit all over the place, with analysis of various of the policies, then an attempt to bring in certain universal elements, but failing to distinguish existing case law such as *Orient-Express Hotels Ltd v Assicurazioni General SpA (UK) (t/a Generali Global Risk) [2010] EWHC 1186 (Comm)*, preferring to opine that it was wrong, although the basis on which much of the law was to be found reflects hundreds of years of practice.

The FCA initially suggested it would be acting in a fair and balanced manner, but its approach has been anything but. The FCA has been almost entirely partisan in its approach acting as quasi-policyholder; it has crowed over the result, suggesting it won on almost every point, but I don't think that it has, either as a matter of the case itself or, more importantly, in the wider context of the market. Whether this matters or not, we will see, but the FCA did not manage to make all of the policies respond.

First, of all, I was pleased to see that the Ecclesiastical policies under consideration were determined to be appropriately non-responsive by the court because of the "infectious disease carve-out" exclusion that they contained. This was expressed as an exclusion, for closure or restriction in the use of premises as a result of an occurrence of an infectious disease. Although the policy did allow for cover in respect of some, specified diseases, COVID-19 was not so specified and therefore the court determined that the policy was designed to cover specific illnesses, but not all illnesses. They criticised the drafting, for inconsistency in terminology, but allowed the defence that the Ecclesiastical provided. I have to say that I thought that the drafting was effective and could not understand why the Ecclesiastical was being pursued on this.

Similarly, two of the QBE policies were found to stand up to scrutiny, because an event or incident could not mean the incidence of COVID-19. Although we should note that other QBE policies were found by the court to respond.

Thirdly, although the judgment is a bit hard to follow, the Zurich found its all risks policies with action of a competent authority (AOCA) clauses that prevented access to premises were similarly robust because of:

- The concept of prevention requiring premises to be forced to close. 84% of the Zurich's policies covered premises that were never the subject of Government imposed closures.
- The narrow and localised cover envisaged by use of the words "in the vicinity of the premises". The court did not consider, "contrary to the FCA's submissions that the entire country can be described as in the "vicinity" of the premises." Frankly, the varied approaches that the court adopted towards the term "vicinity" will not be helpful in future cases, but this one at least we can agree with.

Fourthly, Arch won in part, because of considerations of prevention, although a business that operated a takeaway service would be potentially covered.

Finally, the rather odd case of the policy underwritten by MS Amlin and MS Amlin 3, which covered forges, which are not generally visited by the general public, had never been ordered to close and under which policy no claims had been made. While the policy covered both prevention and hindrance, the court did not believe that consideration of the policy was really necessary.

As for the case itself, the FCA was unable to convince the court regarding the proposition that a speech from the Prime Minister or the meeting at the Treasury with some insurers was enough to impose restrictions, change the terms of the contracts or indeed bind the market. The FCA also took a hit on the various non-damage denial of access (NDDA) and AOCA clauses. The first type required an "incident" to occur within a one-mile radius of the premises resulting in denial of access or hindrance in access to the premises, imposed by the authority. The court determined that COVID-19 was not an "incident", which the FCA tried to conflate with a danger or an emergency. Instead, it was an event, as proposed by Counsel, a one-off type of arrangement. Also, the cover envisaged was narrow and localised and prevention was only going to occur where the government had ordered a closure. The FCA had tried to suggest that government advice and guidelines could be seen as "action taken" and so imposed appropriate restrictions. This meant the term "prevention" would have been covered and indeed the FCA attempted to conflate this with hindrance. The court rejected this, and as the point was helpfully made by Lord Sumption in The Times, quoted his letter in full, approvingly.

In terms of the AOCA clauses (mentioned in the paragraph on Zurich above), the clauses under consideration looked again at the term "prevention". The court concluded that only total closure could be deemed "prevention". Furthermore, the clause envisaged a narrow, localised form of cover, when using the term "vicinity". The key point for the court was that the AOCA clause focused on the prevention of access to premises for the purpose of carrying on a business, not prevention per se, nor hindrance. This practical approach and the court's commentary around the creation of these types of clauses (NDDA and AOCA) to deal with terrorist incidents, where a bomb might be in the vicinity (i.e. the same street) and the authorities would wish to clear the area, defuse any unexploded bombs or otherwise prevent further damage, suggest the court sympathised with the defendants, who pointed out that these clauses had been drafted without any infectious disease in mind.

Finally, the FCA attempted to set things up to say COVID-19 was everywhere, which meant that a policyholder didn't have to prove the outbreak of COVID-19 in their area and would see this as meaning that they could claim. The court suggested that a further trial be held to consider the incidence of COVID-19, which the FCA rejected, leaving the burden of proof in some instances, to determination of whether or not there was an incidence of COVID-19 in the nearby area resting upon the policyholders.

What is much more problematic in my view is the broader damage to the law. For example, rejection of the well-established *contra preferentem* rule early in the case, and other Latin tags that were referred to in shorthand and which form some of the principles of construction. Equally, the confusion over the meaning of the term "vicinity" presented by the court, where on some policies, the term is widely construed, and on others, narrowly. Terms which have long had established meanings - "event", "occurrence", "following" - are considered by the court, argued about, but not consistently applied.

The court throughout criticised the wordings of the policies, which I have a lot of sympathy with. Indeed, early on, the court suggested that policies were put together using an approach based on a clause having a settled meaning by reason of its being used against a background of longstanding and clear authority. I would love to think that the wordings were indeed put together on this basis; I fear that it would be too much to expect. But, and I think this is important to note, it is not too much to expect of insurance companies to do this in future. Policies are the products insurers sell and it is about time that their constructions and wordings were properly considered. Too many times they are drafted on a "cut and paste basis" with exclusions and extensions being jammed on, all without a proper review. Perhaps this judgment will bring about some change in this area?

Early in the judgment, the court decided to avoid following the *Orient Express* case. At paragraph 79 of the judgment, the court dismissed it on the basis that it was comparatively recent, a first instance decision, had been the subject of critical commentary from the insurance textbook writers and there had been no judicial commentary of it. They went on, later in the judgment, to go through the decision in greater detail and found fault with the judgment of Hamblen J. It is all very well, but they failed to distinguish the case, which has impacted insurance contract drafting and approaches over the last few years, and evidently considered that they didn't have to follow normal practice regarding other first instance decisions, which are generally seen as persuasive to a court of first instance. Their biggest excuse for not distinguishing *Orient Express* is that the case involved a different type of peril. It will be interesting to see if the case goes to appeal, as Hamblen J has been moved

upstairs since it was heard, to the Supreme Court, so this could be a case of "marking your own homework".

Further, the court appears to have ignored some of the rules of contract construction with which the Supreme Court is currently grappling. At the moment, the Supreme Court is focusing on contract wording and rejecting the more purposive construction approach that had crept in with more Civil Law and European Law influences. Indeed, the failure to be guided by this seems to be a key issue that the Supreme Court will want to put right, if there is to be an appeal. I was particularly horrified by a comment at paragraph 142 of the judgment: "We do not consider that construction is dictated by the words used".

A clear problem concerns the political nature of the court's decision making. The court has essentially, it seems to me, determined what it wants to reach as its decision to back the regulator, and strains to do so, sometimes sounding rather tetchy. I am disappointed to note that the judgment has that flavour, something I have not believed to be the case before. In a way, deciding in favour of the regulator is the easy way out, but the regulator is just that, and not an authority on contract construction, insurance contracts in particular and insurance law. It makes no sense, and while politically it is expedient to try and spread the cost of the pandemic, it would be much better to get universal agreement on the part of the insurance industry rather than some form of compulsion.

I see the test case decision as damaging the industry the FCA is supposed to regulate, which surely cannot be in line with the principles by which the FCA has to abide. The damage caused by the FCA becoming a cheerleader for policyholders means the regulator has damaged trust in the insurance industry and enabled it to be seen as essentially failing in their duty to pay. Unsurprisingly, along with a current trend, insurance companies have seen their reputations nose-dive; policies designed for different risks have been forced to respond to those they have not priced for and wording designed around terrorism and bomb attacks has been interpreted in a manner which was not intended, thanks to the way in which the FCA presented its case. Furthermore, the PRA should be involved as prudential issues are now likely to arise since the insurers are faced with paying up for risks they can't afford and didn't price accordingly. There may well be reinsurance cover available and this will assist the frontline insurance companies, but it's not really a solution, as the likelihood is a raft of reinsurance litigation arising. As a result, we see the decision pushing business offshore (note that French insurers are not paying as tribunals are finding in their favour) and, as the reinsurance industry does not expect to pay, or needs to consider how it is going to pay for it all, the combination of the bullying approach of the FCA in its litigation tactics means that there is going to be little trust or co-operation going forward. Why would you voluntarily want to submit to the jurisdiction of such a capricious, policyholder-driven regulator?

Even so, is the FCA truly policyholder-driven? It seems to me that the case will ultimately damage any policyholders' position. The likely outcomes are that insurers will pull out of business lines, cover will be limited and prices will go up. Given that the court has not given the FCA a carte blanche, policyholders will still need to meet the tests under the policies that apply and there will be no cheque in the post for many of them. In the future, policy wordings will likely be longer and more restrictive (although I should point out that wordings are possibly a big beneficiary here, if the case has the effect of forcing companies to look more closely at them). So, insurers will need to take these more seriously: it is their product and it is what they sell and they need to take ownership rather than farming it out to those who don't have the same interest in the preservation and maintenance of their capital. The current system has been found wanting with constant amendments, tweaks, exclusions and extensions being made to the policies. The court has criticised the drafting and wording of policies, and has taken the opportunity in a way, to find the solution by highlighting the cracks. In essence, the court has run water between those cracks, freezing it and busting the policies. The court has pointed out that it expects there to be full understanding of the words used and the reasons for doing so; this requires an understanding of the law and background to the wordings used in the market. The inconsistencies and poor wording of policies has enabled the court to find against the insurers. Time to bring this in-house or use external lawyers, rather than brokers, to draft the wording. We are already seeing policy wording specialists suddenly becoming in demand.

Does any of this really matter? Well, on the day that the decision came out, Hiscox saw its share price go up: with its losses crystallised and the excess handed on to the reinsurance companies, they could breathe a sigh of relief. It is clear from the judgment that insurers have used this as a possible negotiating point: is it going to be another case of the insurers taking the view that they will pay now, but in future it's going to be a case for a Flood Re or Pool Re situation? BI Re anyone?

As for what insurers and others can do now in the light of this quite surprising decision, I would suggest the following:

- Consider stopping writing BI cover, whether temporarily or permanently.
- Wait for the Supreme Court decision, if there is an appeal.

- The four "Rs": reword the policy, reprice the premiums, add to the reserves, check your reinsurance.
- If outsourced, who drafted the policy wordings and can I sue them?
- Law firms and brokers who did any of the drafting should be looking out their files and checking the advice they gave when revising the wording suggested.

The FCA sent a "Dear CEO" letter to insurers on 18 September, the summary of which states:

> "The High Court judgment on the test case has brought greater clarity and certainty for all parties. It is critical that this results in insurers paying valid and successful claims in full at the earliest possible date to support business and consumers during the current situation. Where we see that insurers are not meeting the expectations set out here, we will use the full range of our regulatory tools and powers to ensure they do so. We will also continue to co-ordinate closely with the Financial Ombudsman Service.",

which is a classic of its kind.

Apparently, the court's judgment is clear and provides certainty for all parties. I would suggest that the test case has in some cases muddied the waters and is not a model of clarity for insurers to follow. The FCA adopting a threatening tone is unhelpful to say the least. But while many of us thought that an appeal was inevitable, one of the most surprising outcomes may be that no or only a limited appeal is made because insurers have been required to pay out less than feared. Can the FCA actually adopt the right look while appealing a decision that they have trumpeted as a win, will insurers want to go through the weary, intensive process of an appeal or settle for what the court has already partly decided and will lawyers eventually get closure on the *Orient Express* case, not to mention some new points to argue about in terms of insurance wording?

We await the next instalment of the saga!

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