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BUSINESS INTERRUPTION CLAIMS UNMASKED

AN ANALYSIS OF THE UK SUPREME COURT DECISION IN THE COVID-19 CLAIMS TEST CASE AND ITS POTENTIAL IMPACT IN CANADA

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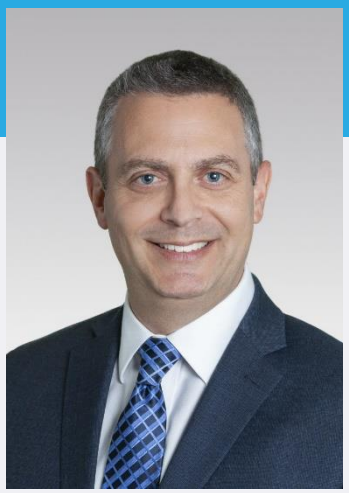

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Just like the rest of the world, the UK economy has been struggling with the effects of the COVID-19 pandemic. Like most other jurisdictions, the UK has imposed varying degrees of restriction on personal and business activity in an effort to slow the spread of the disease. Unsurprisingly, those restrictions have wreaked havoc with many businesses, as their ability to operate normally has been necessarily curtailed.

Many of those businesses have insurance policies which cover them against loss arising from interruption of the business due to various causes. Thousands of claims were made under such policies. In many cases, denials were issued, often on the basis that the policies do not cover effects (or certain effects) of the pandemic. Given the economic importance of these questions, the Financial Conduct Authority ("FCA") - the regulator of the insurance industry in the UK - brought a test case to clarify whether or not there is coverage in principle for COVID-19 related losses under a variety of different insurance wordings. The trial of the issues proceeded over eight days in the summer of 2020 and the judgment of the Court was given on 15 September 2020. That decision was appealed to the UK Supreme Court (the UK's highest judicial authority) and the Court's anxiously awaited decision was handed down on 15 January 2021.[1] Of interest to the North American market, the reasons address the following:

- "disease clauses", which cover business interruption losses resulting from any occurrence of a notifiable disease within a specified distance of the insured premises;
- "prevention of access clauses", which cover business interruption losses resulting from public authority orders

[1] See *The Financial Conduct Authority v. Arch Insurance (UK) Ltd. and others* [2021] UKSC 1.

preventing access to, or the use of, business premises, and "hybrid clauses", which contain both disease and prevention of access aspects;
- The causal link that is required between business interruption losses and the occurrence of a notifiable disease (or other insured peril);
- The effect of "trends clauses", which describe a standard method of quantifying business interruption losses by comparing the performance of a business to earlier results.

While this decision will undoubtedly be of interest to insurers doing business in Canada, it is important to note that the language under consideration by the UK Supreme Court differs in certain respects from the policy wording commonly used in Canada and the United States. However, as one of the only appellate level common law decisions, this case will offer guidance to North American judges who are called upon to consider similar coverages. This paper will briefly discuss the findings of the UK Supreme Court, and the potential impact of the decision on Canadian coverage issues.

Disease Clauses

For the purposes of its decision, the Court used the "RSA 3" disease coverage wording as an exemplar. This wording provided:

> ***We shall indemnify You in respect of interruption or interference with the Business during the Indemnity Period following:***
>
> a. ***any***
>
> *i.* ***occurrence of a Notifiable Disease (as defined below) at the Premises*** *or attributable to food or drink supplied from the Premises;*
> *ii.* *discovery of an organism at the Premises likely to result in the occurrence of a Notifiable Disease;*
> *iii.* ***occurrence of a Notifiable Disease within a radius of 25 miles of the Premises****;*

There is little doubt that COVID-19 meets the definition of "notifiable disease" in most jurisdictions, including all Canadian provinces and territories, as well as the UK. So the first question for the Court in addressing this clause was generally the meaning to be ascribed to the words "*occurrence of a Notifiable Disease within a radius of 25 miles of the Premises*", and more specifically to identify the scope of the peril insured against. Does it cover only the business interruption consequences of any cases of a Notifiable Disease which occur within a 25 mile radius of the insured premises, or does it cover the business interruption consequences of a Notifiable Disease wherever the disease

occurs, provided there is at least one case of illness caused by the disease within that radius?

The Supreme Court concluded that the insured peril was not the disease generally or an outbreak of the disease, but rather illness sustained by any person resulting from that disease within the geographic boundary. Thus, the disease clause in question provides cover for business interruption caused by any cases of illness resulting from COVID-19 that occur within a radius of 25 miles of the insured premises, with each case being a separate occurrence. The clause does not cover interruption caused by cases of illness resulting from COVID-19 that occur outside of that area. However, and as will be seen in the discussion on causation below, the wording does not confine cover to business interruption that results only from cases of the disease within the 25-mile radius as opposed to other cases elsewhere.

Many policies issued in Canada use a form of "disease clause" referred to as "Food Borne Illness Coverage". An example of typical wording is as follows:

> *This policy insures, up to a limit of $25,000, loss … resulting from interruption of or interference with the business carried on by the Insured at the premises as a direct result of:*
>
> *a) infectious or contagious disease manifested by any person while at the premises or an outbreak of a notifiable human infectious or contagious disease within 20 kilometres of the premises;*
>
> …
>
> *The insurance provided by this endorsement is subject to the following special condition and to all the conditions of this policy, except as specifically modified herein.*

A key distinction between the RSA 3 wording and the above is the fact that the former is premised on an "occurrence" of the disease while the latter is based on an "outbreak". While it did not do so in the context of this policy wording, the UK Supreme Court addressed some of the issues inherent in this difference in wording, and pointed out that "occurrences" of the disease are much simpler to identify than "outbreaks". If the RSA 3 wording had referred to any "outbreak" of a notifiable disease, this would have created obvious problems of deciding what constitutes an outbreak, and by what criterion it is possible to judge whether a large number of cases of a disease are all part of one outbreak or are part of or constitute a number of different outbreaks. By contrast, the word "occurrence" is known to refer to

something which happens at a particular time, at a particular place, and in a particular way.

Most food borne illness coverages do not contain a definition of "outbreak", so Canadian courts will likely be faced with the analytical challenge noted above. In Canada, "outbreak" is defined in some provincial legislation as an occurrence of disease within a geographic area that exceeds normal expectations.[2] This definition is consistent with the definition used by the World Health Organization: "*The occurrence of disease cases in excess of normal expectancy*."[3] While these seem to provide sensible and workable definitions, the approach to be taken by Canadian courts remains to be seen. Suffice it to say that, in Canada, it will necessarily be the "outbreak" (however that is defined) that comprises the peril insured against, and not individual cases of disease. But the UK Supreme Court's determination that cover is not confined to the presence of COVID-19 within the defined radius will likely be persuasive to a Canadian judges. It would not surprise us if a Canadian court – so long as an outbreak within the defined area is identified – similarly concludes that the interruption or interference need not be solely the result that particular outbreak.

Prevention of Access Causes

In addressing the prevention of access clauses, the Court primarily concerned itself with two questions: (1) the meaning of "restrictions imposed by a public authority" and whether this was limited to restrictions created by statute; and (2) when restrictions placed upon an insured's use of its property would amount to an "inability to use" the property as required under the insuring agreement.

As to the first question, the Court found that restrictions did not need to be enshrined in statute or to have actual force of law in order to fall within the insuring agreement. The Court reasoned that "restrictions imposed" by a public authority would be understood as ordinarily meaning mandatory measures imposed or directed by the authority pursuant to its powers. While the word "imposed" connotes compulsion that is normally exercised by government through the use of statutory power, this is not a specific requirement. An instruction given by a public authority may amount to a "restriction imposed" if compliance with it is required, and would reasonably be understood to be required.

Canadian policies commonly refer to "order of civil authority" in similar extensions to coverage. Most of these policies require that the

[2] *Assisted Living Regulation*, BC Reg 189/2019 (Community Care and Assisted Living Act); *Communicable Diseases Regulation*, NS Reg. 196/2005 (Health Protection Act); *Public Health Protection and Promotion Act*, SNL 2018, c. P-37.3.
[3] "Disease Outbreaks", World Health Organization.

order be issued as a result of physical damage to neighbouring property, but some policies are "triggered" more simply by a "fortuitous and unforeseen event", which wording does not require physical damage to property. In such cases, the reasoning of the UK Supreme Court would likely be relied on by Canadian courts in concluding that "orders of civil authority" do not require duly enacted legislation, but can be "triggered" by the issuance of instructions from a public health authority, with which compliance is understood to be required. While the Canadian wording requires an "order" as opposed "restrictions imposed" – and could therefore require a greater degree of governmental compulsion – it would not be a stretch for Canadian judges to conclude that instructions from public health officials can amount to an "order" even if not formally enacted.

The Court next considered the meaning of "inability to use" property due to restrictions imposed by a public authority, and whether a complete loss of use was required. The Court concluded that impairment or hindrance was not enough and that an actual "inability" to use property had to be demonstrated by the insured. However, the Court found that different business purposes could be distinguished in this analysis leading to a broader application. It concluded that the requirement would be 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. In both cases there is a complete inability to use.

As alluded to above, an "inability to use" trigger for coverage is uncommon in Canada, and most similar coverages are premised upon actual physical damage to property. However, in cases where "restricted access" coverage may be available in the absence of physical damage, this reasoning will be persuasive to a Canadian court when considering situations where an insured has experienced a total loss of use of a discrete part of its business activities, such as where a dine-in restaurant is limited to take out or delivery and has effectively "lost" the ability to use its dining room.

The Court also briefly considered the meaning of the word "interruption" and concluded that it was capable of encompassing interference or disruption that does not bring about a complete cessation of business or activities and that may even be slight. Again, this reasoning will likely be persuasive to Canadian judges (who thus far have not provided a definitive meaning in the context of business interruption), although its effect will likely be muted given the general requirement for physical damage as a precursor to coverage under policies issued in Canada.

Causation

Given the Court's conclusion that the disease clauses provide cover for business interruption caused by any cases of illness resulting from COVID-19 that occur within a radius of 25 miles of the insured premises, a key question was whether losses attributable to measures taken in response to pandemic on a national level (and therefore not "caused" by a local occurrence) could be seen as the legal cause of an individual loss. It obviously could not be said that any individual case of illness on its own caused the government to impose restrictions that led directly to business interruption. So how then is the question of causation to be addressed?

The Court answered this question by first observing that: (a) the parties to the policy could not reasonably be supposed to have intended that cases of disease outside the radius could be set up as a countervailing cause that displaces the causal impact of the disease inside the radius; and (b) the relevant wording did not confine cover to a situation where the interruption of the business resulted only from cases within the radius. Had the insurers wished to impose such a restriction, it was incumbent on them to set it out clearly in the policy.

Moreover, the Court reasoned that requiring an insured to show that the interruption was solely a result of a discrete incident of disease within the radius in assessing cover would result in irrational effects and a need for arbitrary judgment. Accordingly, the Court concluded that in order to show that loss from interruption of the insured business was proximately caused by one or more occurrences of illness resulting from COVID-19, it is sufficient to prove that the interruption was a result of Government action taken in response to cases of the disease that included at least one case of COVID-19 within the geographical radius covered by the clause. This conclusion is based upon the premise that each of the individual cases of illness resulting from COVID-19 that had occurred by the date of any Government action was a separate and equally effective cause of that action (and of the response of the public to it).

The Court adopted the same approach for "hybrid" clauses, which provide cover for loss as a result of restrictions placed on a business as a result of a notifiable disease manifesting itself at the insured premises or within a certain radius of it. 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 a closure or restrictions placed on the premises in response to cases of COVID-19 that included at least one case manifesting itself within the specified radius.

This causation analysis will likely be highly influential on any Canadian court called upon to assess the issue. It is not unreasonable

to expect a similarly robust approach to causation in Canada, and an eventual ruling that so long as one case is established within the specified radius, then any loss will be seen as caused by broad-based restrictions imposed in response to the pandemic.

The Trends Clauses

Whether issued in the UK, the US or in Canada, most business interruption clauses contain "trends clauses", which allow for the calculation of business losses based upon past performance. While such clauses are typically addressed as an adjusting exercise, the presence of a global pandemic means that any given business is likely to have suffered a downturn in operations as a result of the wider consequences of the pandemic, regardless of the impact of any individual or local case. The Court addressed the question of whether that fact should be taken into account in assessing any individual loss.

Consistent with the view noted above that each individual case of COVID-19 will be seen as a separate and equally effective cause of any restrictions designed to slow the spread of the virus, the Court held that the trends or circumstances for which adjustments should be made do not include trends arising from the same underlying or originating cause as the insured peril, namely the COVID-19 pandemic. Rather, the trends clauses should be construed so that loss calculations are only adjusted to reflect circumstances that are unconnected with the insured peril and which are not inextricably linked with that peril. In the result, the amount recoverable by a policyholder will not be reduced if – had the business not faced restrictions – its turnover would have been lower in any event as a result of other consequences of the pandemic.

Executive Summary and Takeaways for Insurers Doing Business in Canada

In essence, the decision in the FCA case found:

1. Policyholders with "disease clauses" will be covered if there is an occurrence of a case of COVID-19 within the specified radius;

2. "Prevention of access clauses" (and similar "order of civil authority" clauses) will likely be triggered by government instructions even if those instructions are not contained in statute or regulations. The key question is whether the instruction would be understood to be mandatory;

3. An "inability to use" property may be demonstrated where the policy holder is unable to use its premises for a discrete part of its business activities, or is unable to carry out business activities on a discrete part of its premises;

4. A complete cessation of business is not required to demonstrate an "interruption";

5. To establish causation, it is sufficient for a policy holder to show that there was at least one case of COVID-19 within the indicated geographical radius at the time of the restriction. All individual cases of COVID-19 which existed at the time of any restriction will be seen as equally effective proximate causes of the restrictions.

6. When it comes to adjusting losses the court held that claims should not be reduced to account for a downturn in business due to COVID-19 which would have occurred even if cover had not been triggered by the insured peril.

As above, the specific policy language reviewed by the UK Supreme Court differs in many respects from its Canadian counterparts. However, the ruling is certain to influence and guide any Canadian court that may be called upon to consider COVID-19 related business interruption coverage, particularly in respect of disease clauses, causation and trends clauses. Insurers doing business in Canada should not underestimate the importance of this decision outside of the UK.

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