Hot TopICS

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Business Interruption Test Case – what next, following the Supreme Court judgements?

The FCA brought the test case on behalf of Business Interruption (BI) policyholders to resolve the contractual uncertainty around the validity of many BI claims arising from the Covid-19 pandemic. The High Court's judgment last September, based on a sample of policy wordings, said that most of the disease clauses and certain prevention of access clauses did provide cover. That judgement was substantially upheld on appeal to the Supreme Court.

The Supreme Court judgements provide an authoritative interpretation of common BI wordings and an important steer to insurers as to whether the prevalence of coronavirus, in or near an insured business, should be regarded as the effective cause of loss.

Although the court judgments did not go into the ramifications of subsequent UK Government action including 'local' or 'tiered' lockdowns, they have provided clear-cut guidance and a basis upon which the FCA seeks to ensure that regulated firms do the right thing and treat policyholders fairly.

This article aims to highlight the key messages from FCA on BI claims and some of the practical aspects that brokers should consider in the light of the court rulings.

Claims

Whereas determining claims is a job for insurers, brokers are in the front line dealing with queries from clients and need to be aware of the issues and what is expected of them. The court ruling gives firms plenty to consider – importantly, how Covid-19 can be proved and the how insurers will go about handling a potentially large volume of complex claims.

The courts interpreted approximately 700 policy wordings from around 60 insurers in all – eventually, 14 out of the 21 policy types tested were found to have the potential to provide cover in response to the pandemic; 9 were not.

Although the outcome of the test case is welcome news for many policyholders, it should be remembered that the legal arguments were about 'Non-Physical Damage Business Interruption' clauses covering areas such as Infectious Diseases & Denial of Access. Most BI policies do not have this cover and therefore, despite upbeat (some misleading) messages from the media, the outcome of the test case does not alter the position for many businesses that simply have no insurance cover for losses

arising from the pandemic and other non-physical damage events. Nevertheless, it is clear that more claims are going to be valid following the Supreme Court judgements.

The judgments mean that previously rejected claims (and complaints), especially those relating to infectious or notifiable diseases, non-damage denial of access and public authority closures or restrictions, could be valid. In some cases, the value of claims will have changed.

In addition, cover may be available for partial closure of premises (as well as full closure) and for mandatory closure orders that were not legally binding. The ruling also means that valid claims should not be reduced because the loss would have resulted from the pandemic in any event.

Expectations

The FCA issued a 'Dear CEO' letter on 22 January 2021 outlining its expectations of insurers. The FCA instructed insurers to reassess all BI claims affected by the test case in the light of the judgments, including those previously rejected or not fully paid and to write directly to all their policyholders with affected claims or complaints within the week to explain their next steps.

The regulator made it clear that businesses with valid BI claims should receive the payments due to them as soon as possible. Its objective is to ensure that slow payment does not exacerbate financial pressures and insurers are expected to seek, where possible, to make interim or part payments for ongoing claims. Insurers are also expected to reconsider on a case-by-case basis the appropriateness of seeking to make deductions from claims settlements to offset any financial support the policyholder might be able to claim from the government.

In the letter to insurers, the FCA also noted the key role that insurance brokers and other insurance intermediaries have in working with insurers to ensure that policyholders' valid claims are progressed as quickly as possible.

Policy wordings

Having identified the policyholders potentially affected by the judgements, the crux of the matter for insurers and brokers is the actual policy wording. The FCA has published a table to show how and to what extent policies in the representative sample may respond to BI losses arising from the pandemic – or, more precisely, the government's measures announced in March 2020 to address the evolving crisis.

The FCA has also provided a policy checker & FAQs which can be used by policyholders and brokers as a guide to see whether a particular wording is the same as, or very similar to, the 21 policies in the representative sample. Declarations have also been published by each of the parties to the test case, indicating whether the whether the policies in the representative sample potentially cover BI losses arising from the pandemic.

It is important to bear in mind that individual policies still need to be considered against the detailed judgments and the extent of the cover they provide. Policy details such as indemnity periods, the basis of settlement, any provision for business trends, increased cost of working etc. will all influence any eventual settlement.

Brokers may well identify potential claimants whose insurers are not listed or whose policies are not immediately comparable to any in the representative examples. These cases may require a more

in-depth understanding of the arguments presented in the court ruling and will need careful attention and consideration by the insurers.

Depending on the policy wording, it may be necessary to prove the presence of at least one case of Covid-19 in a particular zone relative to the policyholder's premises. Reported NHS and Government data on Covid outbreaks may be helpful. The FCA is currently consulting on guidance for policyholders, insurers and intermediaries on proving the presence of Covid-19.

However, policies requiring the presence of disease within a given area (vicinity), where events that occur within such area would be reasonably expected to have an impact on a policyholder, will not need to prove the presence of Covid-19. This was the ruling of the High Court in the test case RSA4, which looked at the policy type underwritten by Royal and Sun Alliance and various other insurers. FCA guidance suggests the same approach should be used where policies extend the definition of 'vicinity' to 'an area surrounding or adjacent to an insured location'.

Policies where the 'occurrence' of a notifiable disease is required will not, as with those with vicinity clauses, need to prove the presence of Covid-19. This was confirmed within the Hiscox1-3 (Hybrid clauses Court declaration 3). Again, the FCA guidance suggests the same approach should be used where other policies have similar worded clauses.

Irrespective of the technicalities, brokers need to liaise with insurers on claims, monitor progress and keep clients informed as appropriate.

Disputes

The insurance industry in general was never geared up to provide BI cover for a global pandemic but, as highlighted by the court cases, insurers' wordings have not been clear enough in that regard. Some insurers that never intended to provide pandemic cover must now respond to Covid-related claims, particularly where their package policies designed for retail, hospitality and leisure sectors included non-damage BI extensions. The majority of commercial customers, however, will not have the relevant extensions and relevant cover would not have been an option for them when the policy was sold.

So, some claimants will be happy to hear that their claims will be paid, while others, especially given the difficult financial and economic conditions, may seek to raise disputes with brokers - such as why their policy does not pay out when other policyholders in a similar position have claimed successfully.
It is essential for brokers to maintain clear complete and up-to-date records of any discussions and transactions that take place with clients and to give them suitable information about the products they offer. In the event of a complaint such records are invaluable.

Firms need to follow their complaints procedures strictly and, in the event a resolution looks unlikely, ensure professional indemnity insurers are notified. Firms will often have to bear a considerable excess for each successful claim.

Small business policyholders are entitled to take unresolved complaints to the Financial Ombudsman Service (FOS). The FOS will take into account the court judgements, but their decisions are generally based on what is fair and reasonable and the outcome of any broker disputes will be of great interest.

Broker firms should remain vigilant regarding insurers whose solvency status might be adversely impacted by the weight of Covid claims and, in some cases, review their placement strategy. The

possibility of Covid claims should be noted on firms' internal risk registers and the potential cost of claims taken into consideration as part of wider strategic decisions.

Brokers' Professional Indemnity cover

Any claims for which a broker may be liable are notifiable under the firm's PII policy. PII policies are generally written on a claims-made basis which means they respond to claims notified during the period of insurance, rather than when the insured event occurred. Firms should be clear about their insurers' strict notification requirements and ensure they are complied with.

However, some insurers have imposed exclusions or restrictions on pandemic-related claims since last year's crisis. At the same time, increased premiums for PII reflect the current hard market.

FCA rules require (among other things) continuous cover at the specified minimum level 'in respect of claims for which the broker may be liable as a result of the conduct of itself, its staff and its appointed representatives'. That means brokers should make every effort to source the required PII cover without exclusion.

If a firm that offers commercial BI insurance is forced to accept PII cover with a relevant exclusion, the regulator's general notification requirement would kick in - firms must notify the FCA of matters having a serious regulatory impact. Principle 11 also requires firms to disclose any matters which the regulator would reasonably expect notice.

It is recommended that brokers start the process of renewal of their PII earlier than they would ordinarily to ensure they obtain adequate coverage and, wherever possible, mitigate any unfavourable terms.

Further information

FCA webpages on BI: https://www.fca.org.uk/firms/business-interruption-insurance

The FCA's legal team at Herbert Smith Freehills has published a bulletin summarising the judgment on their website: https://hsfnotes.com/insurance/2021/01/15/supreme-court-hands-down-judgment-in-fcas-covid-19-business-interruption-test-case/

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