COVID-19 AND BUSINESS INTERRUPTION INSURANCE

TWO STRONG JUDGMENTS PROVIDE EARLY GUIDANCE

The Financial Conduct Authority v Arch Insurance (UK) Limited and others, September 2020

TKC London Ltd v Allianz, October 2020

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The potential for recourse to business interruption insurance is a hot topic for commercial leaseholders whose premises have been affected by Covid-19 restrictions. Two recent decisions of the Commercial Court therefore provide helpful guidance. For those who hold relevant policies containing "disease" clauses there may be good news. Not so, and perhaps unsurprisingly, for those with standard "damage" based insurance coverage.

Whilst much depends upon the wording of an individual policy, in very general terms, "disease" clauses are provisions which provide coverage in respect of business interruption in consequence of or following or arising from the occurrence of a notifiable disease within a specified radius of the insured premises. In contrast, "standard" business interruption cover is broadly contingent on the occurrence of physical or material damage to insured premises.

So, let's start with the good news. Subject to the outcome of the pending (leapfrog) appeal to the Supreme Court, in *The Financial Conduct Authority v Arch Insurance (UK) Limited and others* [2020] EWHC 2448 (Comm), Lord Justice Flaux and Mr Justice Butcher (sitting together in the Financial List), have considered the terms of some 21 "lead" business interruption policies containing various "disease" extension clauses in the light of business interruption caused by Covid-19. The litigants' stated mutual objective is to provide the maximum clarity possible for the maximum number of policy holders and their insurers.

In relation to each specimen clause selected, and against a background of rejected claims, there was a question whether there is cover in respect of a pandemic where it cannot be said that the key matters which led to business interruption, and in particular the Government measures, would not have happened even without the occurrence of Covid-19 within the specified radius, as a result of its occurrence or feared occurrence elsewhere. The Judges interpreted the clauses turning on the requirements of "vicinity" in a robust common-sense fashion. They decided that most, although not all, the disease clauses considered at trial provided cover in the current

Pandemic. The FCA estimates some 700 other types of policies across over 60 different insurers and 370,000 policyholders are potentially affected by this test case.

Whether individual tenants with the benefit of such extensive business interruption insurance can take comfort from the first instance ruling will, however, ultimately depend upon whether their particular type of business was actually *required* by law to close. This involves careful consideration of the 26 March Health Protection (Coronavirus, Restrictions) (England) Regulations 2020 and equivalent Regulations made in Wales, Scotland and Northern Ireland Regulations. Broadly speaking, and by way of example, the leisure sector falls on the right side of this line. Restaurants, bars, cinemas, nightclubs and spas *were* amongst the businesses required to close their premises under the 26 March 2020 Regulations.

And now the bad news. This has come in the form of the judgment in *TKC London Ltd v Allianz* [2020] EWHC 2710 (Comm) for insured tenants holding "standard" cover. Indeed, with the emphatic force of a successful application for summary judgment against the insured claimant running the arguments considered. As the Deputy High Court Judge put it, the facts provide something of a "footnote" to the detailed *FCA* decision. The relevant "All Risks" policy considered contains very common wording and no "disease" extension.

The claimant in *TKC* operated a café restaurant which was forced to close under the Regulations from 21 March to 4 July 2020. It was insured under a "Commercial Select" policy. The policy included cover for business interruption and damage to property. The claimant contended that it was entitled to be indemnified by its insurer in respect of the losses resulting from the interruption or interference with its business caused by the closure of its premises and/or the loss or destruction of its stock.

The business interruption section of the policy provided cover for business interruption "by any Event". "Business Interruption" was defined as loss resulting from loss or interference with the business in consequence of an event to property used by the insured at the premises for the purposes of the business. "Event" was defined as accidental loss, destruction or damage to that property. A proviso to the basis of settlement clause required there to be an insurance in force covering the insured's interest in the property against such event. The property damage section provided cover for damage to property insured at the claimant's premises. "Damage" was defined as accidental loss, destruction or damage to the insured property. Business interruption or property damage caused by or consisting of inherent vice or gradual deterioration was excluded from the coverage provided.

Taking the issue of the claim for loss or destruction to stock first, the Judge noted that the definition of "Business Interruption" required the interruption or interference to be "in consequence of an event to property used by the Insured at the Premises". Accordingly, the claimant's factual assertion that the deterioration in TKC's stock *caused* (proximately or otherwise) any relevant interruption or interference with TKC's business was "wholly unrealistic". The deterioration of TKC's stock during the period of closure did not cause TKC's business to be interrupted or interfered with, because it occurred at a point at which that business was already closed as a result of the Coronavirus Regulations. As the Judge put it, the loss of the stock was a consequence of the interruption or interference, not its cause.

Similarly, the phrase "accidental loss or destruction of or damage to property" was not apt to include the natural process of the decay or deterioration of unsold stock. What occurred to the stock was not "accidental" in the sense in which that word was used in that definition. If more was needed, the Judge held that the "inherent vice" exclusion was applicable.

The claimant's argument that the Property Damage Section of the policy responded to the closure of TKC's premises (and was therefore "an insurance in force .. against such Event"), was dismissed. Considering the policy wording in context, and as taking colour from that context, the word "loss" was intended to refer to physical rather than economic loss. A mere temporary loss of use was not "Damage" as that expression was defined. In order to amount to "loss .. of .. Property Insured" within the cover provided by the policy, the insured had to show that it had been physically deprived of that property in circumstances (where it was not plainly irrecoverable) making its recovery uncertain. That was not what had happened.

TKC's principal ground of claim was that the prohibitions imposed by the Regulations were "an event to property used by the Insured at the Premises for the purposes of the Business" within the definition of "Business Interruption" in the policy, and that the enforced closure of the premises (and consequent loss of use of them) amounted to "accidental loss .. of .. property used by the Insured at the Premises for the purposes of the Business" within the definition of "Event" in the policy. The Judge accepted that the enforced closure of TKC's premises as a result of the Regulations was an "interruption of or interference with the Business carried on by the Insured at the Premises" and that that interruption or interference was "in consequence of an event to property used by the Insured at the Premises for the purpose of the Business". However, this took matters no further. Whilst the word "event" simply meant an occurrence

or happening, the key point was that the policy only responded to "Business Interruption by any Event", as "Event" was defined.

The crucial issue was therefore whether the enforced closure could properly be said to be "accidental loss .. of .. property" within the definition of "Event". Again, the Judge held, the words of the policy strongly suggested that "loss" was similarly intended to have a physical aspect. Taking contextual matters into account as a whole, the expression "loss .. of .. property" in the definition of "Event" could not sensibly be interpreted as including mere temporary loss of use of property. As a result, TKC had no valid claim for the temporary loss of its business premises.

In conclusion, whilst expressing considerable sympathy for those businesses which have suffered during the Pandemic (as the insurance company itself did too), the Judge stressed that the rules of interpretation must be followed. To this end, he cited the observations of the authors of the BIICL Concept Note "Breathing Space"[1]:

> "*In times of uncertainty, the law must provide a solid, practical and predictable foundation for the resolution of disputes and the confidence necessary for an eventual recovery .. Contractual rights are to be evaluated by applying settled principles to the contract in question. Legal certainty remains paramount and gives the surest basis for resolution ...".*

Wise words indeed.

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26 October 2020

[1] Blair, Lein, Gullifer, Fu, "Breathing space", BIICL Concept Note 2 on the effect of the 2020 pandemic on commercial contracts (May 2020) at [68]-[69].