Case Bulletin: FCA Test Case: High Court signals good news for holders of business interruption insurance and creditors of distressed businesses

In its decision in the matter of *The Financial Conduct Authority v. Arch and Others*[1], the High Court has provided some welcome news for businesses who have suffered disruption as a result of the COVID-19 pandemic and the government response thereto.

Case Summary

The action, brought by the FCA under Practice Direction 51M to obtain authoritative English-law guidance on matters of sufficient urgency and importance, sought to examine 21 sample insurance policies from 8 different insurers (including Hiscox, Zurich, and QBE) to determine their applicability in the context of the pandemic.

The policies were broadly split into three categories according to the situations they were envisaged to insure against, those being:-

- **Disease Wordings[2]:** Broadly, these clauses concern interruption to the insured's business as a result of the occurrence of a notifiable disease within a specified radius of the insured premises;

- **Prevention of Access Wordings[3]:** These are policies concerned with hindrance to the use of, or access to, the insured premises as a consequence of government restrictions; and

- **Hybrid Wordings[4]:** those policy wordings which refer to both restrictions imposed on the premises and the occurrence of a notifiable disease.

The judgment, spanning over 150 pages, considered each of the 21 policy wordings in turn and particularly the question of whether the occurrence of COVID-19 within the specified radius, or the governments institution of lockdown measures (or both, as the case may be) would be considered to trigger the policy coverage for the insured.

In short, the court found that in the case of a significant number of the business interruption policies examined, the event of COVID-19 and/or the government's lockdown protocols did trigger the policy wording and the insured was accordingly covered. More specifically, the court found the following in respect of each of the categories of policy wording:

- In the case of 'disease' wording, most (but not all) of the policies would be triggered by the outbreak of COVID-19 in the specified area. Policyholders may demonstrate this requirement using NHS or ONS Deaths Data and reported cases, but need not specifically demonstrate an outbreak in their local vicinity, as under most wordings the outbreak of the disease need not be only in the specified area.

[1] https://www.fca.org.uk/publication/corporate/bi-insurance-test-case-judgment.pdf
[2] *ibid,* para. 80 onward
[3] *Supra,* note 1, para. 306 onward
[4] *Supra,* note 1, para. 242 onward

This results in a very high likelihood of policyholders with 'disease' wording in their policies having a potential claim under their policies.

- 'Prevention of access' clauses were to be construed in a narrower way than their 'disease' counterparts. The applicability of such clauses will be contingent mainly on the precise wording of the policy and the interpretation of government protocol against the Insured's particular business type - for example, some government guidelines required the complete closure of restaurants, but permitted continued operation of takeaway services. In such circumstances the former would constitute a complete prevention of access, while the latter would simply be an interruption; any policy wording would have to be construed accordingly. While 'prevention of access' wording is therefore less likely to trigger coverage, it still remains a possibility on construction of the individual clauses.

- 'Hybrid' clauses would be interpreted with the interpretation of the other two categories of clause in mind and would be heavily contingent on the particular terms used therein.

While the potential for an appeal on the part of the Insurers remains, the FCA has been quick to issue guidance to insurers following the decision urging them to progress relevant claims swiftly and as far as possible, so as to ensure there is little delay to policyholders if and when any such appeal is found in the insured's favour.

Quantum

The calculation of the monies recoverable under a number of the sample wordings provided to the Court was by reference to a 'trends' clause. These clauses essentially stipulate that the amount recoverable by a policyholder claiming for business interruption takes into account trends in the business's financial health at the time of the relevant interruption. The insurers argued that one such 'trend' was the COVID-19 pandemic itself, and therefore any effective recovery under the policy would be stifled by the effect the downward economic trend was having on the business at the time of the interruption (and thereby following the decision of the High Court in *Orient Express Hotels Ltd [2010] EWHC 1186*).

In a further finding welcome to policyholders, the Court found that such arguments were fallacious, and in the case of most policies this would render cover "*largely illusory*". Instead, the Court found (in *obiter* comment) the case of *Orient Express Hotels Ltd* would be decided differently today. Meaning that, in a large number of the sample wordings, quantum would be assessed without reference to the insured peril to which the policy referred (be that 'disease', 'prevention of access', or a combination of both), and thereby potentially aiding policyholders further in their recovery under such policies.

Impact on Policyholders

The decision sets a welcome precedent for holders of the relevant policies who have endured forced closure or business interruption during the COVID-19 crisis. The decision of the High Court in this instance will provide a shortcut for many policyholders to obtaining the benefit of their policy, demonstrating the usefulness of the Part 51M procedure and potentially benefitting over 370,000 policyholders.

In particular those policyholders who hold wording similar to that of the 'disease' wording detailed above have gained enhanced prospects of recovery following the decision; even still, holders of policies with 'hybrid' or 'prevention of access' wording should not be perturbed from examination of their policy wording against those examined by the High Court. It is notable that the decision is not contained to the first instance of lockdown in March 2020, and therefore the government's more recent introduction of lockdown measures on 22 September may still allow for a 'second bite of the cherry' in respect of 'prevention of access' and 'hybrid' wording. Policyholders should therefore consider their position resultant of both the Spring and Autumn lockdowns.

Policyholders should still, however, consider the impact that their current actions may have on their prospects of recovery; while the Test Case clarifies the situations where COVID-19 will be a trigger of the relevant policies, other ancillary factors such as delay in notification of business interruption, or arrears in premium payments, may still impact the availability of coverage provided by any relevant policy. Policyholders are therefore strongly recommended to review their policies for obligations they may have when a covered business interruption occurs.

A list of potentially affected business interruption policies is contained here.

Potential benefits to Creditors of Distressed Businesses

In addition to the obvious benefit to policyholders of the High Court's decision, an unexpected benefit may be conferred on creditors of distressed businesses where the latter was the holder of a valid business interruption policy which is activated by the provisions above.

Insolvency Practitioners

The decision means that administrators/liquidators of insolvent businesses should now check the insurance policies held by the business to see if a claim can be made against the insurer in relation to business interruption. If such a claim is successful, it means that creditors of businesses holding these policies should see an improvement in their dividends.

Secured Creditors

Secured creditors of any distressed business should make contact with the insolvency practitioner to enquire whether the business benefitted from such a policy. If so, the lender should review its security to confirm if the policy forms part of the security portfolio.

In many cases the answer may not be clear cut. The drafting of the key terms of the security document often vary in relation to insurance policies as to whether there is:

- an assignment by way of security;
- a purported fixed charge, which may be considered a floating charge recovery; or
- a floating charge sweeping up all other assets.

The return for the secured creditor may be significantly impacted by a legal review of the exact wording of the security document. For example, being able to lay direct claim to the benefit of the policy under a perfected legal assignment is likely to result in better return than claiming through the insolvent estate under a floating charge which is subject to the deduction of the prescribed part (amount set aside from floating charge realisations for unsecured creditors) and expenses of the estate.

For this reason, a secured lender benefitting from a further assurance clause may be well advised to consider requesting a specific assignment of any policy containing business interruption provisions before any insolvency is envisaged and/or as a condition of any forbearance.

*Third Party (Rights Against Insurers) Act 2010 ("**TPRAIA**")*

Pursuant to the TPRAIA, in situations where a person ("B") incurs a liability to another ("A"), and the liability to A is one in respect of which B is insured, should B enter into an insolvency process, A gains the right to enforce its rights directly against B's insurer.

It is thought to be unlikely that TPRAIA will apply to affect a transfer of the insured's (B's) rights against its insurer directly to the general body of creditors, or one of them. However, the application of TPRAIA may be arguable in certain specific cases where, perhaps, a particular creditor has insisted on a business interruption policy being taken out as a condition of its engagement with the insured. In such cases, it may well be worth that creditor (or class thereof) considering if TPRAIA applies to allow it to recover the benefit of the insurance without first passing through the insolvency estate.

If you are a policyholder, officeholder, or creditor (whether secured or unsecured) to a distressed business and would like more information in relation to the decision in the FCA test case or anything mentioned in this article, contact the authors at the details below:

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