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Business Interruption Insurance: Wide Area Damage

The recent Supreme Court decision in *The Financial Conduct Authority v Arch Insurance (UK) Ltd & Others ([2021] UKSC 1)* considers various Business Interruption policy coverage issues. One aspect of the decision impacts upon wide area damage claims and may be of interest to certain refinery owners.

Introduction

Numerous different events can cause wide area damage. Such events can be categorised as follows.

- Natural phenomena e.g. earthquake.
- Weather events e.g. hurricane, typhoon, flooding.
- Accidents e.g. explosions.
- Deliberate acts e.g. terrorism.

In addition to damage being sustained by property used by the Insured at their own premises, such events can also give rise to damage being sustained, in the wider area, by parties other than the Insured.

The issue of claims adjustment practices, in the event of wide area damage, has come before the UK courts again during the recent pandemic Business Interruption claims disputes. Specific consideration has been given as to whether the "other circumstances clause" (also known as the "trends clause") can be used to adjust the standard turnover or revenue figure, upon which an Insured's Business Interruption loss is calculated, so as to take into account the result of damage sustained by the property of other parties in the wider area.

The Position at English Law Before the High Court Decision in *FCA v Arch*

The position at English Law, prior to the recent case of *The Financial Conduct Authority v Arch Insurance (UK) Ltd & Others,* rested with the decision in *Orient-Express Hotels Ltd v Assicurazioni Generali SpA (UK) (t/a Generali Global Risk) ([2010] EWHC 1186 (Comm)).*

Orient-Express Hotels Ltd owned the Winsor Court Hotel in New Orleans and the hotel sustained significant physical damage following the impact of Hurricane Katrina in 2005. Business Interruption coverage was underwritten in accordance with a UK style policy wording.

Coverage was available under denial of access and loss of attraction extensions to the policy. However, such extensions limited cover to a much lower level than the overall limit that applied to the main body of the policy.

Accordingly, the Insured sought to progress their claim under the main body of the policy.

So far as the insuring clause and "trends clause" were concerned, Orient-Express Hotels' policy wording was based upon the standard Association of British Insurers policy form. Whilst Orient Express Hotels' insuring and "trends" clauses referred to "Damage", rather than the standard UK term of "Incident", the definition of "Damage", similarly to the standard "Incident" definition, related to *"direct physical loss destruction or damage to property used by the insured at the Premises".*

The insuring clause in question stated that insurers agreed to *"indemnify the Insured … against loss due to interruption or interference with the Business directly arising from Damage and as otherwise more specifically detailed herein."*

The "trends clause" expressly provided that in the event of a claim the adjusted figures should *"represent as nearly as may be reasonably practicable the results which but for the Damage would have been obtained during the relative period after the Damage".*

Under the main body of the policy, Generali rejected the Insured's claim for business interruption losses, during the period the hotel was closed, by applying the "trends clause". Underwriters position being that during the period the hotel was closed the whole of New Orleans was effectively "closed" and that as such the standard revenue the Insured would have earned during that period, but for the damage to their hotel, would have been zero.

At arbitration, Orient-Express Hotels contested Generali's application of the policy wording. However, the arbitration tribunal found in favour of underwriters, concluding that the "but for" causation approach to the loss, as specified by the "trends clause", was correct. Accordingly, the business interruption loss was to be assessed on the basis that the hotel was undamaged but the City of New Orleans was devastated. The arbitration tribunal supporting Generali's position that business interruption losses would have occurred even if the hotel had not been damaged.

At the High Court, Orient-Express Hotels appealed against the arbitration tribunal's award. The High Court concluded that it had not been established that the tribunal erred in adopting the "but for" approach to causation. The judge noting that the "trends clause" made it clear that the recoverable loss should be calculated on the basis of what would have happened but for the damage to the property used by the Insured at their own premises. Accordingly, with the City of New Orleans itself being closed down, the hotel would not have received visitors even if it the hotel had been undamaged.

The High Court also considered the claimant's position that it was a generally accepted principle that where there are two proximate causes of a loss an Insured can recover under the policy if one of the causes is an insured peril, provided that the other cause is not excluded. The judge did not accept that this principle should apply to concurrent independent causes.

The court also rejected arguments made by Orient-Express Hotels that the "trends clause" should not be allowed to encompass consequences of the same peril that gave rise to the insured damage. The judge supported the tribunal's position that *"the fact that there was other damage which resulted from the same cause does not bring the consequences of such damage within the scope of the cover".* The judge observing that the "trends clause" was not concerned with the causes of damage.

The High Court dismissed the Insured's submission that Generali's stance created the remarkable position that the more widespread the impact of a natural peril the less cover is afforded by a Business Interruption policy.

The decision in *Orient-Express v Generali* contrasted with how many UK market insurers had responded to a number of previous Business Interruption claims involving high profile wide area damage.

A "School of Thought" remained that the decision in *Orient-Express v Generali* unduly prejudiced policyholders.

The Position at English Law After the High Court Decision in *FCA v Arch*

Whilst the High Court in *FCA v Arch* made distinctions from the case of *Orient-Express v Generali,* the Court nonetheless analysed the latter decision due to the reliance placed on it by Arch and others.

The High Court expressed the view that *Orient-Express v Generali* was wrongly decided and that they would not have followed the decision had it been relevant. In particular, the High Court concluded that there had been a misidentification of the insured peril. The High Court, in applying the established insurance doctrine of proximate cause, concluded that the hurricanes, as the cause of the "Damage", were an integral part of the insured peril.

Accordingly, based upon the position of the High Court in *FCA v Arch*, Orient- Express Hotels' claimable loss should have been arrived at by comparing the revenue that would have been earned but for the hurricanes against the revenue that was earned after the material damage caused by the hurricanes.

The Position at English Law After the Supreme Court Decision in *FCA v Arch*

The aforementioned High Court proceedings were brought by The Financial Conduct Authority as a test case relating to the significant number of business interruption losses suffered as a result of the Covid-19 pandemic. Therefore, allowing for such exceptional circumstances, the Court of Appeal was bypassed and the appeals proceeded directly to the Supreme Court.

So far as the decision in *Orient-Express v Generali* was concerned, the Supreme Court went further than the High Court and decided that the case should be overruled.

The Supreme Court's analysis of *Orient-Express v Generali* was that the error had been in the application of the "but for" causation test i.e. but for the occurrence of the insured peril, would the loss have been sustained? The Supreme Court did not consider the "but for" test to be appropriate.

In the original case of *Orient-Express v Generali* it was held that the business interruption loss suffered by the hotel would still have occurred "but for" the insured peril (the damage sustained by the hotel). The cause of the business interruption being the damage to the City of New Orleans not simply the insured peril trigger of the damage to the hotel.

The High Court, in *FCA v Arch*, expressed the view that *Orient-Express v Generali* was wrongly decided based upon the definition of insured peril. The insured peril being the cause of the damage, namely, damage by the hurricanes. Accordingly, it was necessary to compare the revenue that would have been earned by the hotel but for the hurricanes with the revenue that was earned after the damage caused by the hurricanes.

In the Supreme Court's opinion, the business interruption loss, suffered by the hotel, arose because both the hotel and the surrounding area and other parts of the City of New Orleans were damaged by the hurricanes. Therefore, there were two concurrent causes, one being an insured peril (the damage to the hotel), the other being an uninsured peril (the damage to the wider area) and each of which was by itself sufficient to cause the business interruption loss under consideration.

The Supreme Court went on to state that when an insured and uninsured peril operate concurrently, and arise from the same underlying fortuity (i.e. the hurricanes), then provided the damage proximately caused by the uninsured peril (i.e. damage to the rest of the City) is not excluded, the loss resulting from both causes operating concurrently is covered.

The Supreme Court concluded that "trends clauses" ordinarily relate to quantification of the loss and not the scope of the indemnity, the latter being addressed by the insuring clause. Accordingly, if possible, the "trends clause" should be construed so as not to take away coverage provided by the insuring clause, otherwise the "trends clause" (designed to quantify the loss) would be transformed into an exclusion.

The Supreme Court recognised that "trends clauses" can expressly call for a "but for" test. Accordingly, the Supreme Court sought to interpret such "trends clauses" without giving rise to any inconsistency with regards to their interpretation of causation in relation to the insuring clauses.

Therefore, the Supreme Court concluded that, in the case of *Orient-Express v Generali*, the "trends clause" should not have been construed so as to reduce the standard revenue figure to take into account the wider impact of the hurricanes. Instead, the "trends clause" should have been construed so as to arrive at results that would have been achieved if the insured peril had not occurred and if circumstances which had the same underlying or originating cause as the insured peril had not occurred, namely the hurricanes. Accordingly, in the case of *Orient-Express v Generali,* the standard revenue figure should not have been subjected to a downward adjustment in respect of the wider impact of the hurricanes.

Application

Clearly, in respect of the issue of wide area damage, the decision of the Supreme Court in *FCA v Arch* is favourable to policyholders so far as Business Interruption claims adjustment practice is concerned.

The relevant policy terminology considered in the case of *Orient-Express v Generali* was based upon standard policy wordings produced by the Association of British Insurers. The diversity of Business Interruption policy wordings means that each claim must be judged on its own merits and in accordance with the applicable policy wording. However, the recent decision undoubtedly strengthens the position of a claimant faced with a Business Interruption loss impacted by wide area damage, especially in respect of insurance contracts that are subject to, or persuasive to, English Law.

So far as refinery risks are concerned, no one standard policy form exists. However, it should be noted that clauses do exist that enable the "turnover" and "revenue" approach of the standard Association of British Insurers wordings to be converted to an "output" option, thus allowing a claimable loss to be calculated based upon loss of production.

The business model of most refineries means that the issue of wide area damage will rarely become a factor in downstream Business Interruption claims. However, the location and business model of some refineries mean that the recent decision in *FCA v Arch* may well be of assistance in the event of certain losses involving wide area damage. For example, certain refineries in the Caribbean supply the domestic market and are situated in a region that can be impacted by severe weather events.

Further Details

Since our formation, Trident has advised interested parties in respect of Business Interruption policy coverage relating to one of the largest refinery losses of recent years. Our team members are available to discuss any issues arising from this article.

February 2021

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Trident specialise in providing insurance coverage advice to policyholders from within the oil & gas industry. In particular, we offer advice and representation during the preparation, negotiation and settlement of insurance claims. Our experience encompasses exploration, construction and operational risks. For full and further details please visit our website www.tridentclaims.co.uk or contact us directly.

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