COVID-19 AND BEYOND: FCA TEST CASE'S IMPLICATION FOR HONG KONG

The UK Supreme Court's first judgment in 2021 marks a turning point in insurance law for those underwriting business interruption risks. In its judgment, the UK Supreme Court interpreted disease clauses, prevention of access clauses and trends clauses in sample policies[1]. Given the common law origin of Hong Kong law, the Test Case by the UK's Financial Conduct Authority (FCA) will likely have a bearing on future Hong Kong insurance cases concerning the COVID-19 pandemic.

1 For a detailed summary of the FCA Test Case rulings, please see https://www.hfw.com/Wider-consequences-of-the-Supreme-Court-judgment-in-the-FCA-test-case-Jan-2021, an article by Jonathan Bruce and Alex Walley of our London office.

The *New World* case and the FCA Test Case

1. Disease Clause: A Consistent Approach

Hong Kong courts are no stranger to disease clause in an insurance policy. In *New World Harbourview Hotel Co Ltd v ACE Insurance Ltd* (2012) 15 HKCFAR 120 (**New World**), the Court had to consider the following clause, in the context of business interruption resulting from Severe Acute Respiratory Syndrome (**SARS**):

> *This Policy is extended to insure actual loss sustained by the Insured, resulting from a Reduction in Revenue and increase in Cost of Working as a result of [...] infectious or contagious disease [...] all occurring on the Premises of the Insured or of notifiable human infectious or contagious disease occurring within 25 miles of the Premises.*

In that case, there was no SARS case occurring on the premises, so the only possibly applicable limb is the 2nd limb, i.e. notifiable disease occurring within 25 miles of the premises. Given the size of Hong Kong, the parties proceeded on the basis that any occurrence of SARS would have been within 25 miles of the premises.

The Hong Kong Court of Final Appeal decided that coverage is only triggered after SARS has become "notifiable". Hence, the only issue left for this limb is how and when the disease would become "notifiable".

Based on ordinary commercial people's understanding of the insurance policy, the Court of Final Appeal held that "notifiable" means a legal obligation or requirement to notify the disease to an authority. The date from which the disease becomes notifiable will be the "triggering date". Being "notifiable" does not include a non-mandatory notification scheme, even when such a scheme is implemented by hospitals. The loss suffered prior to the triggering date was not caused by a notifiable disease, and hence, are not covered by the disease clause.

For Hong Kong, COVID-19 was added to Schedule 1 of the Prevention and Control of Disease Ordinance and the Prevention and Control of Disease (Amendment) Regulation on 8 January 2020.[2] This will likely be the triggering date for similar disease clauses.

The same issue was not disputed in the FCA Test Case. The parties agreed to treat COVID-19 as "notifiable" upon its addition into the UK legislation as a disease for which cases must be reported to the authority. Indeed, the Supreme Court, at [53], also agreed with this reasonable approach. Therefore, on the question of what constitutes "notifiable", the English and Hong Kong cases are consistent.

2. Trends Clause: A Different Approach

In *New World*, the Court of Final Appeal decided that, since coverage is only triggered by a disease becoming "notifiable", those losses which were suffered before the triggering date are **not** covered by the policy. Taking one step further, the Court ruled in favour of insurers' interest on pre-trigger losses.

In *New World*'s High Court decision (affirmed by the Court of Appeal and not disturbed by the Court of Final Appeal), the judge decided that the calculation of loss should include the effect which SARS had on the revenue of the insured up to the triggering date. In other words, even if SARS had already impacted business turnover prior to the triggering date, the calculation of loss would only be based on such diminished business figures immediately before the triggering date.

The FCA Test Case has taken a different approach when considering a trends clause for loss resulting from prevention of access. After analyzing causation and construing the trends clause, the Supreme Court proceeded to hold that, when it comes to calculating indemnity payable by the insurers, the indemnity should not be reduced to reflect a downturn caused by the pandemic's other pre-trigger effect (e.g. downturn in turnover due to COVID-19 before the triggering event). The Court considered any such reduction would essentially mean a refusal to indemnify the insured for loss proximately caused by the insured peril on the basis that the loss was also proximately caused by uninsured (but not excluded) perils with the same originating cause.

The Hong Kong approach is clearly more favourable to insurers, but it remains to be seen whether the Hong Kong courts would switch to adopt the UK Supreme Court reasoning in face of social circumstances.

Before Hong Kong courts have an opportunity to analyse the reasoning in the FCA Test Case, insurers should stay vigilant in terms of contractual language – as pointed out by Reyes J in *New World*'s High Court decision, when the parties have clearly agreed to draw a line for the purposes of comparing what a business earned before and after the advent of an infectious disease and for measuring the consequent loss from such a disease, the Court's giving effect to such a drawn line should not be absurd or unreasonable.

Insights from Other Jurisdictions

COVID-19 has a global impact and how other jurisdictions handle its impact should be of reference as well. Based on the following example cases, insurers are once again reminded of the utmost importance of good drafting. On the other hand, policyholders should still remain cautious as to the terms of policy, in order to ensure that they are not subject to hurdles which may be difficult to surpass given the pure economic nature of business interruption loss.

In a recent Pennsylvanian case *1 S.A.N.T Inc. v Berkshire Hathaway, Inc. and others*[3], the policy only provided coverage for "direct physical loss of or damage" to the covered property. The Pennsylvanian court rejected the plaintiff's argument that losing access to company premises constituted "direct physical loss or damage" and hence, decided that economic loss resulting from mere loss of access (without physical

2 The disease was added to Schedule 1 as "Severe Respiratory Disease associated with a Novel Infectious Agent" on 8 January 2020.. On 29 April 2020, it was renamed as "Coronavirus disease 2019 (COVID-19)".

3 https://www.law360.com/insurance/articles/1345747/pa-court-finds-no-physical-loss-to-restaurants-from-virus?nl_pk=f1899e16-edb6-4947-b233-4d9ffc72cfef&secondary_source=truncated&utm_source=newsletter&utm_medium=email&utm_campaign=insurance

impact to the covered structure) could not be covered.

By way of contrast, the clauses considered in the FCA Test Case and *New World* did not require "direct physical loss or damage" as a triggering element. Therefore, the insured in those cases did not need to establish physical loss at all.

In November 2020, the New South Wales Court of Appeal rejected insurers' attempted reliance on an exclusion clause.[4] The business interruption coverage in that case excluded losses from diseases declared to be quarantinable under the "Quarantine Act 1908 and subsequent amendments", but the Quarantine Act 1908 had been repealed and replaced by the "Biosecurity Act 2015" even before the parties entered into the policy. While the insurer sought to rely on the exclusion clause, the Court held that the expression "and subsequent amendments" was unambiguous and its natural meaning could not extend to the Biosecurity Act 2015. As such, the exclusion clause could not assist the insurer to exclude business interruption losses caused by COVID-19.

Concluding Remarks

As COVID-19 becomes the "new normal", more related cases will no doubt find their way to the court in 2021 and beyond. Although Hong Kong courts' approach to pre-trigger losses seems to be different from UK Supreme Court, there is no telling whether Hong Kong courts would change their view for a better analysis – just as Lord Hamblen and Lord Leggatt did in the FCA Test Case. The UK Supreme Court's detailed analysis on causation and the limits of the "but-for" test will also have a far-reaching impact on all insurance cases and beyond. In any event, insurers should always remember the importance of drafting and policyholders should remain cautious as to the terms of policy.

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4 *HDI Global Specialty SE v Wonkana No. 3 Pty Ltd* [2020] NSWCA 296.