Appeal No. 2020/0177-0178

IN THE SUPREME COURT OF THE UNITED KINGDOM

ON APPEAL FROM

THE HIGH COURT OF JUSTICE, BUSINESS AND PROPERTY COURTS,

COMMERCIAL COURT (QBD)

FINANCIAL LIST

Neutral Citation: [2020] EWHC 2448 (Comm)

BETWEEN:

THE FINANCIAL CONDUCT AUTHORITY

Appellant

-and-

(1) ARCH INSURANCE (UK) LIMITED

(2) ARGENTA SYNDICATE MANAGEMENT LIMITED

(3) ECCLESIASTICAL INSURANCE OFFICE PLC

(4) HISCOX INSURANCE COMPANY LIMITED

(5) MS AMLIN UNDERWRITING LIMITED

(6) QBE UK LIMITED

(7) ROYAL & SUN ALLIANCE INSURANCE PLC

(8) ZURICH INSURANCE PLC

Respondents

-and-

HISCOX ACTION GROUP

Intervener

WRITTEN CASE OF THE FIRST RESPONDENT (ARCH)

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*References to the hearing bundle are in the form **[Bundle/Tab/Page]***

INTRODUCTION

1. This is the Respondent's Case of Arch Insurance (UK) Limited ("**Arch**"), the First Respondent to the appeal brought by the Financial Conduct Authority ("**the FCA**"). Arch has also brought its own appeal in this matter, set out in its Written Case dated 30 October 2020 **[B/4/101]**.

2. The following grounds of appeal raised by the FCA concern Arch and are resisted by Arch:

   (1) The FCA's Ground 1 (Pre-Trigger Perils) **[B/2/29]**.

   (2) The FCA's Ground 3 (Prevention of Access) **[B/2/50]**.

RESPONSE TO FCA GROUND 1: PRE-TRIGGER PERILS

3. Arch's position is that even if Arch's appeal against Declarations 11.1 and 11.2 **[C/1/6][C/1/7]** fails, Declarations 11.4(c) and (d) **[C/1/7] [C/1/8]** should remain undisturbed and the FCA's appeal against those declarations should be dismissed.

4. The FCA does not challenge Declaration 11.4(b) **[C/1/7]**. However, the effect of the FCA's position on Ground 1 **[B/2/29]** is that this Court should prevent insurers in all cases from taking account of a measurable downturn (or indeed upturn) in turnover due to Covid-19 before the insured peril has operated. On any view, the FCA's appeal on Ground 1 is ambitious: it seeks to legislate for all cases, even though the facts of none of them have been investigated in these proceedings and no expert evidence on the relevant principles of adjustment or accountancy has been heard.

5. It remains to be seen whether the FCA accepts that, if Arch's appeal against Declarations 11.1 and 11.2 succeeds **[C/1/6][C/1/7]**, Ground 1 of its appeal falls away. That is the logical position: the core criticism which the FCA advances in respect of the Court's reasoning which leads to Declarations 11.4(c) and (d) is that it is allegedly inconsistent with the Court's reasoning on the so-called Counterfactual Point and with Declaration 11: see Paragraphs 24-27 of the FCA's Written Case **[B/2/37]-[B/2/38]**. If the Court's reasoning in that respect is rejected, the alleged inconsistency disappears.

6. Arch addresses Ground 1 of the FCA's appeal on the assumption that its appeal on the construction of the insured peril, causation, and the application of the trends clause has failed. However, it is worth noting that the FCA's arguments on Ground 1 illustrate some of the consequences of the Court's erroneous approach to construction of the insured peril and therefore to causation. See, for example §29 of the FCA's Written Case **[B/2/39]**: "the Court's findings necessarily mean that for the post-trigger period the parties intended that the insured recover for losses that would have occurred even without the public authority restrictions" (the FCA's emphasis).

7. The Arch CCC policy **[C/4/192]** provides an indemnity against loss of gross profit during the Indemnity Period, being "the period during which The Business results are affected due to the Damage, starting from the date of the Damage and lasting no longer than the Maximum Indemnity Period" **[C/4/224]**. For the non-damage extensions, it was agreed between the FCA and Arch (and accepted by the Court) that "Damage" in the indemnity provisions is to be read as referring to the operation of the relevant insured peril: see §341 of the Judgment **[C/3/101]**.

8. The insured is therefore able to recover to the extent that the results of the business have been affected by the operation of the insured peril, starting from the date when the insured peril first operates (and obviously not, for example, when the first element in the causal sequence leading to the insured peril commences). In the case of premises which are required to close as a result of government advice or action taken in response to the emergency, the indemnity commences when the premises were required to close, not when the emergency began.

9. If, by the commencement of indemnity, the business has already suffered a downward trend in turnover due to the emergency, the FCA accepts that the pre-peril reduction in turnover is not recoverable, because the emergency is not the insured peril. The FCA's argument that once the peril operates, an indemnity should be paid as if the prior downward trend had not occurred, is contrary to principle and also contrary to the effect of the Arch trends clause. The FCA's case that the Standard Turnover (for a period when the emergency was not operating) should be used, unadjusted, to calculate the indemnity due to the insured once the peril has operated and the policy

has been triggered, ignores the Policy's requirement for adjustment to give effect to "any" "trend or circumstance" before or after the insured peril operates, and for the adjustment to "represent, as near as possible, the results which would have been achieved during the same period had the [insured peril] not occurred" **[C/4/225]**.

10. If the FCA's position were correct, it would appear to apply with equal force to a business which benefited from an upward trend in turnover due to the emergency, such as a high street business in a commuter town whose turnover rose as a result of the growing number of workers working from home, and not commuting into the city, during March but whose premises had to close on 20 March 2020 as a result of the government action taken in response to the emergency. On the FCA's case, that business should be indemnified for the effects of the closure as if the pre-peril increase in turnover had never taken place. The business would be left significantly under-indemnified for its loss.

11. Contrary to the FCA's case, a measurable upturn or downturn in turnover, prior to the operation of the insured peril, is plainly a "trend or circumstance" for the purposes of the Arch Policy and cannot be ignored in calculating the indemnity once the peril has operated.

12. Using the unadjusted Standard Turnover, without taking account of the pre-peril trend, to calculate the indemnity once the peril has operated would be to under- or over-compensate the insured. The movement in turnover which occurred before the operation of the insured peril is not the fortuity against which the insured had protected itself. It should not, therefore, be removed from the Counterfactual or disregarded as a trend or circumstance. There is no reason why uninsured effects of the emergency should be left out of account, simply because in due course the emergency leads to government action or advice which results in the prevention of access.

13. The Court's reasoning, leading to Declarations 11.4(c) and (d) **[C/1/7][C/1/8]**, although relatively briefly expressed in the Judgment, does not make the suggested elementary mistake of confusing an indemnity against pre-trigger losses (which the FCA accepted is not recoverable), with the effect, after the policy has been triggered, of a downwards prior trend. It is obvious from §351 of the Judgment **[C/3/133]**, read

as a whole, as well as from §389 of the Judgment **[C/3/142]** and from the trial transcript where the point was debated between the Court and the FCA's Counsel **[G/24/180]-[G/24/182]**, that the Court concluded, correctly, that it would be wrong to ignore a measurable downwards trend in turnover, which existed prior to the operation of the insured peril, when calculating the indemnity during the insured period once the peril had operated, simply because this trend was caused by the emergency. The effect of the argument to the contrary, which requires one to ignore a measurable downwards trend once the peril has operated, is to compensate the insured for the (uninsured) loss which began before the peril operated and which would have continued during the indemnity period. Using the FCA's example at §32 of the FCA's Written Case **[B/2/40]**, ignoring the measurable 30% downwards trend, when calculating the indemnity in week 2, and awarding the insured 95% rather than 70%, is to compensate the insured for a loss which has already materialised and which was not insured.

14. Contrary to the FCA's assertion, there is no inconsistency between the Court's conclusion as to the effect of a pre-peril downward trend and the correct counterfactual. Declaration 11.4(d) **[C/1/8]** prevents an insurer from arguing that, once the peril has operated, the emergency would have caused a further reduction in turnover, ie by accelerating the downwards effect of the existing trend. In fact it is the FCA's example at §32 **[B/2/40**] which gives rise to artificiality, by reversing out the effects of the disease from the actual pre-indemnity experience of the insured business. In contrast, the Court's approach avoids a hypothetical re-writing of the pre-indemnity experience because it requires the loss to be assessed by reference to the actual experience of the business at the commencement of the indemnity period.

15. The Court's example at §389 of the Judgment **[C/3/142]** is therefore also correct in principle and consistent with the Court's reasoning on the counterfactual. The downward trend in the church's collection income, due to the pandemic, before the operation of the insured peril, is not insured. It is not the fortuity against which the insured has protected itself. It is not to be removed from the counterfactual, or disregarded as a trend, because it is not, at that point, part of the insured peril. Once the insured peril operates, it is not open to the insurer to argue that the downward trend would have accelerated, even if the church had not been required to close

(because of the Court's finding on Counterfactual, assumed to be correct for these purposes). But the reduced level of income, as at the date of the occurrence of the insured peril, does not fall to be ignored when calculating the indemnity available for the loss of income during the period of closure ie once the peril has operated.

16. The Court's example at §389 of the Judgment **[C/3/142]** also illustrates the falsity of the FCA's point on inextricability and therefore on practicalities. There is no sensible objection, on the grounds of inextricability or impracticality, of taking into account a "measurable downturn in turnover" or "increased expenses" due to Covid-19 which has already occurred by the time that the insured peril takes effect. By definition, Declaration 11.4(c) only applies where there are such "measurable" effects **[C/1/7]**. The downturn attributable to uninsured events can be measured not only by the actual experience of the insured business before the indemnity period commenced but also by the actual experience of the insured business after the indemnity period ceased. Any counterfactual used by insurers to quantify the loss must be consistent with the actual experience of the business on either side of the indemnity period. To ignore that actual experience would result in a wholly unrealistic counterfactual, contemplating a level of turnover which would never in fact have been achieved during the period of indemnity.

17. As for the FCA's point on "emerging perils" (FCA Written Case, §§18 and 34 **[B/2/34][B/2/40]**), this is also a false point. The relevant peril, in Arch1, operates as and from an identifiable date: the date when access is prevented for the specified reasons. If the insured has taken steps in anticipation of the operation of the insured peril, those steps are not indemnifiable. The fact that the emergency, when it operates in combination with other matters, leads to the operation of the insured peril (the prevention of access), does not mean that the emergency, in isolation, is "an emerging/developing peril that would have existed before the full combination was in place" (FCA Written Case, §18 **[B/2/34]**). The emergency is not the peril in the Arch policy, nor is a step taken by the insured in anticipation that an insured peril might occur.

18. There is nothing surprising or inconsistent with the Court's reasoning on the Counterfactual in the conclusion that, in the hurricane example discussed at §38 of the FCA's Written Case **[B/2/42]**, a measurable downward trend in the hotel's turnover in

the period before the hurricane hits, brought about by concerns about an approaching hurricane, should in principle be taken into account when calculating the indemnity for the post-damage loss of turnover. The effects of the approaching hurricane are simply not insured.

19. The FCA's argument at §42-44 of its Written Case **[B/2/43]-[B/2/44]** that there are implied limits on what constitutes a "trend" or "circumstance" and that such trends or circumstances are limited to "the vicissitudes of business life, extraneous to the insured peril", is also unprecedented and erroneous. The Arch trends clause **[C/4/224]** refers to "any" "trend" (which suggests a pattern affecting the Business) or "circumstance" (which suggests anything else which affects the Business) and therefore does not readily admit of any implied limitation. It is also wholly unclear what is meant by "the vicissitudes of business life". The FCA's argument also assumes that a measurable downward trend, due to the emergency and before the operation of the insured peril, is not "extraneous to the insured peril". The fact that the emergency is what causes the eventual government action or advice which leads to the prevention of access is not in dispute. But the emergency is not the insured peril. At the time the emergency causes the downward trend, the insured peril has not occurred (and may not occur).

20. As for the extensive treatment of the decisions of the Hong Kong courts in New World Harbourview in the FCA's Appellant's Case at §48-52 **[B/2/46]-[B/2/48]**, the case was relied on by the FCA: see the Judgment at paragraphs §174 **[C/3/88]** and §349 **[C/3/132]**. The Insurers did not assert, at trial, that the case provided any more assistance beyond illustrating the obvious point that pre-trigger losses are not recoverable. That was the only proposition which the Court took from the case and it is not in issue: see Judgment §349 **[C/3/132]**. The decisions are of no obvious assistance on the FCA's appeal on Ground 1.

RESPONSE TO FCA GROUND 3: PREVENTION OF ACCESS[1]

21. This part of the FCA's appeal concerns the meaning of "prevention of access to the Premises" in the Arch policy wordings, which each included a materially identical

[1] See §§100-109 of the FCA's Written Case.

Government and Local Authority Action clause ("**the GLAA Extension**") set out below. The issue is addressed at §§307-336 of the Judgment **[C/3/121]-C/3/129]**, in particular from §324 onwards **[C/3/125]-[C/3/130]**.

22. In summary, Arch resists the FCA's appeal on the basis that the Court reached the correct conclusions as to coverage in its Judgment.

23. The GLAA Extension provides in relevant part **[C/4/227]**:

> *"We will also indemnify You in respect of reduction in Turnover and increase in cost of working as insured under this Section resulting from…*
>
> ***Government or Local Authority Action***
>
> *Prevention of access to The Premises due to the actions or advice of a government or local authority due to an emergency which is likely to endanger life or property…".*

24. Arch has always accepted that the GLAA Extension covers the loss of gross profit sustained by insured businesses whose premises were completely closed as a result of the Government advice of 20 and 23 March and/or the 21 and 26 March Regulations. Arch's position was accepted by the Court. The Court held at Judgment §324 **[C/3/125]**:

> "*We consider that Arch is right that, under the GLAA Extension, it is only where the premises closed pursuant to the 20 or 23 March government advice or the 21 or 26 March Regulations that there was a qualifying prevention of access.*"

25. "The Premises" are defined by the policy: they are the location(s) stated in the applicable policy Schedule where the policyholder carries on the Business described in the Schedule.

26. "Access to the Premises" is plainly the means by which entry is made to the Premises for the purposes of the Business: see Judgment §315 second sentence **[C/3/123]**, reflecting the FCA's position at trial (see FCA Trial Skeleton at §153 **[G/5/16]**). Insofar as the FCA now contends (see §103 of its Written Case **[B/2/63]**) that "access to the Premises" requires an inquiry into <u>who</u> was prevented from accessing the Premises, that is just wrong. The relevant inquiry is into <u>what</u> is prevented, namely the means of entering the Premises for the purposes of the Business.

27. "Prevention" is not a term of art. It is an ordinary word, defined "to mean the action of stopping something from happening or making impossible an anticipated event or intended act": see Oxford English Dictionary **[G/129/2373]**. "Government action or advice" which "prevents" access to the Premises is therefore government action or advice which requires or recommends that the Premises are not to be accessed for the purposes of the Business. In practical terms, therefore, nothing short of action or advice, the effect of which is to require or recommend closure of the Premises, will suffice to lead to a "prevention of access to the Premises".

28. Other provisions of the Arch1 wording are relevant in this context: in particular, Extension 1 (which refers to damage to property in the vicinity of the Premises which "hinders or prevents" access to the Premises) **[C/4/226]** and Extension 3 (which refers to the "use of Premises" being "restricted" on the advice of the competent authority[2]) **[C/4/226]**.

29. As regards Extension 1, the Court correctly contrasted "prevention" with "hindrance" (e.g. Judgment §324 **[C/3/125]**). As the Court noted at Judgment §315 **[C/3/123]**, Extension 1 refers to both hindrance and prevention of access to the Premises and there is an obvious difference between the two, illustrated by the cases referred to at Judgment §§324-325 **[C/3/125]-[C/3/126]**. "Hindrance" bears a broader meaning. Whatever "prevention" means in Extension 1 is therefore likely to be the meaning to be given to "prevention" when used in the GLAA Extension.

30. As regards Extension 3 **[C/4/226]**, "Prevention of access to the Premises" is also clearly different to "restrictions" on the "use of Premises" referred to in Extension 3. The Court correctly concluded that impossibility, rather than something being rendered more difficult, was the touchstone of "prevention" when used in the GLAA Extension. As the Court noted at §326 of the Judgment **[C/3/126]**, what has to result from the government action or advice is closure of the Premises for the purposes of carrying on the Business as defined in the Policy Schedule.

31. The GLAA Extension responds to measures which are directed at the means of accessing the Premises. Restrictions placed on the free movement of persons

[2] The FCA has not alleged that Extension 3 is engaged on the present facts. Covid-19 is not one of the listed diseases which make up qualifying Notifiable Diseases for Extension 3.

generally (even if the restrictions extend to those who may wish to use the Premises) do not affect the means of accessing the Premises and do not prevent access to the Premises. No other advice or actions measures taken in response to the pandemic were capable of triggering the GLAA Extension, as such advice and actions did not require the closure of insured Premises.

32. The FCA now argues that the Court should have held that a "partial prevention of access to the premises for the purposes of the carrying on of the business will suffice." (FCA Written Case §102 **[B/2/63]**).

33. There are several objections to the FCA's case.

34. First, it is clearly not what the GLAA Extension says. The GLAA Extension does not refer to access to the Premises being partially prevented, nor does it refer to access to a part of the premises being prevented. It requires access to the Premises to be prevented, i.e. stopped.

35. Second, it is clear that what the FCA means by a "partial prevention of access" is in fact restrictions placed on the use of the Premises which fall short of prevention of access. The example the FCA gives (despite the practical insignificance, for Arch policies, of Category 1 businesses: see Judgment §318 **[C/3/124]**) of the restaurant which must close for eat-in diners but which is permitted to remain open to carry on an existing takeaway service (Judgment §107 **[C/3/68]**) is not an example involving any "prevention of access" to the Premises. The Premises remain accessible. The restriction is on the use to which part of the Premises may be put: for indoor dining. Where part of the Business is permitted to continue at the Premises, access to the Premises for the purposes of the Business has not been "prevented". There may have been a "restriction" placed on "the use of the Premises" (cf. Extension 3) but there has been no prevention of access to the Premises for the purposes of the GLAA Extension.

36. Third, it is unclear from the FCA's Case how the FCA asserts that there is a "partial prevention of access" to the Premises of those categories of business which are significant for Arch (Categories 3 and 5) and whose Premises were either expressly permitted to remain open (Category 3) or which were not advised or required to close (Category 5) (see Judgment at §§333 and 335 **[C/3/128]-[C/3/129]**), nor for those

businesses within Category 4 which continued to be able to access the Premises to carry out an online business from the Premises (see Judgment at §334 **[C/3/128]**). The FCA's argument that there is any prevention of access to Premises which can and do remain open is hopeless.

37. As to §108 of the FCA's Written Case **[B/2/65]**, the Court correctly held that restrictions on free movement imposed by Regulation 6 of the 26 March Regulations did not prevent access to the Premises (see Judgment §329 **[C/3/127]**). This is so, even if (contrary to Arch's case and the Judgment) one accepts the FCA's argument that a prevention of access to the Premises includes a "partial prevention of access." These restrictions did not prevent access to the Premises even partially.

38. As for the 16 March 2020 advice of the Prime Minister about working from home where possible, social distancing and avoiding going to pubs or clubs referred to in §108 of the FCA's Case **[B/2/65]**, the Court correctly held that this "did not in any sense cause a prevention of access to any premises" (Judgment §328 **[C/3/127]**). Again, this is so, even if (contrary to Arch's case and the Judgment) one accepts the FCA's argument that a prevention of access to the Premises should be included as "partial prevention of access".

39. The Court's Declarations 14.4 and 14.5 **[C/1/9][C/1/10]** should therefore remain undisturbed.

CONCLUSION

40. Arch respectfully submits that the FCA's appeal should be dismissed and that this Court should affirm the declarations made by the Court below accordingly, for the following among other

REASONS

(1) **BECAUSE** (Ground 1) the Court rightly held that the continuation of a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered could in principle be taken into account in the counterfactual as a trend or circumstance (under a trends clause or similar) in

calculating the indemnity payable in respect of the period during which the insured peril was triggered and remained operative.

(2) **BECAUSE** (Ground 3) the Court rightly held that access to an insured's premises is only prevented under the GLAA Extension where the premises have been totally closed for the purposes of carrying on the insured's pre-existing business.

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