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UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

FACULTY OF COMMERCE, LAW AND MANAGEMENT

SCHOOL OF BUSINESS SCIENCES

MCOM DISSERTATION

AN EXPOSITORY ANALYSIS OF THE CONSEQUENTIAL LOSS (BUSINESS INTERRUPTION) POLICY IN LIGHT OF COVID-19 AND THE UK AND SA LITIGATION

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A dissertation submitted to the Faculty of Commerce, Law and Management of the University of the Witwatersrand, in fulfilment of the degree of Masters of Commerce (Insurance and Risk Management) by research.

1 February 2024

V08-PS

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ABSTRACT

The consequential loss (CL) usually referred to as the business interruption (BI) policy, although about 120 years old, has, until recently. not been subject to much litigation and therefore has had little benefit of judicial interpretation. On the other hand, it is one of the most complex of non-life policies. Things changed with the Covid pandemic, in that, the BI policy was subject to considerable litigation. About 2 000 cases were filed in the US with the litigation still ongoing at the time of the writing of this dissertation. The South African and UK courts litigated but on a different aspect of the policy, compared to the US. The US litigation involved the main policy whereas the UK and SA involved an extension to the policy. This extension does not form part of the US policies. The UK and SA courts relied largely on general legal principles of interpretation of contracts, applied to insurance contracts, to reach their conclusions. In so doing, the courts in these jurisdictions paid little attention to the context and construction of the BI policy taken as a whole, including the historical reason for its existence. Nor did the courts consider the issue of insurability to any detailed extent. It is also pointed out that the leading text book on this policy does not approach the policy in terms of fundamental principles. This dissertation systematically sets out the history, purpose, structure and interpretation of this policy, restating the policy in terms of its history and purpose. The dissertation sets out the lessons which can be learnt from the Covid-19 litigation. An analysis is made of the main policy and the extensions having regard for the various wordings of the BI policy. Finally, the possibility of developing a BI policy which may respond to a future event of a pandemic is considered.

Keywords: Consequential loss, business interruption policy, Covid-19 litigation, causation, uninsurability, policy interpretation.

1 STATEMENT OF RESEARCH OBJECTIVE

1.1 Research objective

The absence of a principle-based text-book, which systematically explains and interprets the business interruption (BI) policy, can lead to wrong conclusions on the application of the policy. The primary objective of this dissertation is to address the existing gap in principle-based literature on BI insurance by systematically explaining and interpreting the BI policy. Specifically, the research aims to provide an historical analysis of the development of BI insurance, elucidating its fundamental principles. The focus will be on examining these principles in the context of the Covid-19 lockdown and related litigation. A key aspect involves analysing the principle of causation to determine the insurability of business interruption losses resulting from lockdowns, exploring the conditions under which such losses can be covered by insurance.

1.2 Background to the problem

Insurers globally have used a fairly standard worded consequential loss policy with a variety of extensions, for over a century. The extensions are less standard. The standard consequential loss (CL) policy, commonly referred to as the business interruption (BI) policy was, after a century of earlier attempts, designed and accepted about 120 years ago (MacKen,1928). It began to be commonly referred to as the BI policy probably because this it is easier to explain to consumers; insureds. The CL or the BI policy, is a policy that covers consequential loss incurred as a result of physical damage or loss to insured property. These policies were not intended to nor was it anticipated by insurers that these policies would respond to claims arising from events which do not cause physical damages, such as lock-down situations. These events cause mere financial losses. Over the years extensions were added to the main policy some of which do cover non-physical damage events. The UK and the South African courts ruled that extensions to these policies do indeed respond to Covid-lockdown claims. These extensions are the contagious disease extension.

Business interruption (BI) insurance is one of the four main forms of insurance required by every business enterprise to ensure comprehensive cover. This is so because four forms of losses can be identified. The four main forms are:

- Insurance against loss or damage to property (non-life cover)
    - Business interruption arising out of the loss or damage to property

- Insurance against injury, death or sickness of individuals (Life cover)
- Legal liability claims made against the insured (Liability cover – provided within the non-life market)
- Medical expenses (Medical Schemes cover)

It should be noted that above the business interruption policy is shown to be part of the loss or damage to property insurance and not as a separate form of insurance. It forms part of the non-life cover.

Some may add a fifth insurable risk area that is the risk of living too long which is covered by the retirement funding schemes. This cover may be regarded as an insurance matter since life insurers sell endowment and annuity policies, and manage retirement funds.

A sixth form of loss may be identified; pure financial losses. This category of loss is generally not insured.

The CL policy was introduced to the UK market in the late 1800s and then formally adopted by the UK Tariff Committee and hence the insurance market in 1939 (MacKen and Hickmott, 1963, 5). During the period since 1939, the policy has not been subject to much litigation, and hence, it has not had much of a benefit of judicial interpretation. This changed dramatically with Covid-19 when world-wide it became the centre of extensive litigation, including in South Africa. Structurally, the policy can be divided into two sections: a main section and then extensions to the policy. The policy is not a standalone policy, but is an augmentation to an existing property damage policy (Swiss Re, 2002, 2017a; The Insurance Institute of London, 2012).

South Africa uses a standardised policy form which was contained in the MultiMark series of policies. A copy of this policy is included as Annexure H. This policy was adapted for use in the hospitality industry and was the centre of the SA litigation.

Despite the centrality of the policy, it is not well-known or understood probably because the operation of the policy involves a detailed application and knowledge of accounting. It is for that reason that claims are difficult to deal with. Insurers globally have issued fairly standard BI policies with respect to the main section. The cover provided by the main section is augmented by a variety of extensions. In the legal history of South Africa, only three legal cases have been reported involving the business interruption policy, and only one involved fundamental issues with respect to the policy.

In America, some 2 000 cases were filed against insurers by insureds seeking indemnification against business interruption losses arising out of Covid-19. These cases involved the main section of the policy. By and large in America, these cases have been dismissed (Stern, M & Benon, H, 2021). In South Africa and the UK, the cases involved the contagious disease extension to the main section, used in the hospitality industry. The extension covers a small portion of the total business interruption market. Contrary to market expectations, unlike in America, these cases succeeded. In South Africa the aggregate cost of the BI claims in all probability constitutes the largest cost of claims in South African insurance history from a single event. Most of these costs were however reinsured and thus the bulk of the costs were borne by international reinsurers. Coincidently, however, shortly after the BI claims, in July 2021, the KZN Riots occurred the cost of which may well have equalled or exceeded the costs of business interruption claims. The insured costs of the KZN Riots was covered by the state insurer, SASRIA and easily exceeded the reserves of SASRIA, it reinsurance cover. The government provided additional funding to SASRIA. Thus contemporaneously South Africa experienced two massive insured losses.

Central to the question of insurers paying for Covid-lockdown losses is the question of insurability. The question is, conceptually does this kind of loss fall within the concept of insurability? The concept of insurability though vitally important has only attracted limited attention, academic or otherwise (Berliner 1985; Holbsboer 1995). Since insurance is the payment of the losses of the few by the many, conceptually business interruption losses caused by an universal lockdown are uninsurable (Vivian, 2020; Vivian & Mushai, 2020; Hartwig, 2020b). It should be clear that it would not be possible to transfer multitrillion dollar business interruption losses caused by Covid-19 lockdown to the insurance market. Thus, it was not anticipated that courts would hold insurers liable to indemnify against lockdown caused losses (Hartwig, Niehaus & Qiu, 2020; French, 2014; Hartwig & APCIA, 2020b; Hartwig, 2020c; Kessler, 2021). And, indeed this is the current position in the US where courts are dismissing claims by insureds, basing such decisions on the wording of the main policy (OECD, 2020b; OECD 2021, Stern, M & Benon, H, 2021). In South Africa and the UK courts ruled in favour of insureds, albeit in terms of an extension to the policy. The SA and UK courts arrived at their conclusion by applying the general rules of interpretation of contracts to the BI policy. In these judgements there is very little discussion on the BI policy as a whole or the question of insurability. By relying on the general rules of interpretation, and insurance law, the UK and SA courts concluded by implication that the risk was insured without a detailed discussion on the question of insurability. In a way, this is not surprising given the long existence of this

policy, the absence of judicial precedent, and the absence of a text book which deals with the history, background and fundamental principles of this policy.

There are virtually no authoritative sources explaining the purpose and structure of this policy. The BI policy is one of the most complex of all non-life policies. The leading textbook which in October 2021, is in its eleventh edition. The book Damian Glynn and Toby Rogers, *Riley on Business Interruption Insurance,* is also extremely costly. The earlier editions did not contain a detailed discussion on the historical development of the policy. The BI policy gives rise to complex factual and accounting issues. Most the discussion about this policy centres round complex accounting issues, not structural principles which underpin the policy. Not only is there very little literature on the BI policy, but there is very little systematic analysis of it. Not surprising, the courts, in the UK, referred only briefly to this leading work and in so doing, confined the reference to a mere few lines (*Orient Express Hotels Ltd,* paragraph 21).

With the onset of Covid-19, and as a multitude of claims were lodged against business interruption policy, interest in and the importance of the BI policy came into focus and has been globally scrutinised both by the insurance industry, regulators and the judiciary. This dissertation will examine the problems experienced by insurers with respect to business interruption insurance. The different approaches of the judiciary in different jurisdictions, will be discussed. It will be submitted that part of the problem in dealing with the Covid claims may well be that the policy is not well-known and understood, both by the industry generally and by the courts, and the dissertation will throw light on this issue. This leads to the conclusion that there is a need to systematically set out the history, purpose, structure and interpretation of this policy or, as the title proclaims, to restate the consequential loss policy in the light of the Covid-19 South African and United Kingdom litigation.

1.3 Problem statement

The BI policy, a consequential loss policy used globally for over a century, faces significant challenges in addressing claims arising from non-physical damage events, such as those caused by Covid-19 lockdowns. The policy, historically designed to cover losses resulting from physical damage to insured property, has been subject to limited litigation until the widespread legal disputes triggered by the Covid-19 pandemic. The core issue revolves around the insurability of business interruption losses caused by universal lockdowns, prompting varied responses from courts in different jurisdictions. While courts in the United States dismiss claims based on policy wording, South African and UK courts, particularly in the context of the contagious disease extension, ruled in favour of insureds. The lack of comprehensive

understanding and awareness of the BI policy, coupled with its intricate nature and limited literature, further complicates the adjudication of claims. This dissertation aims to systematically analyse the historical development, purpose, structure, and interpretation of the BI policy, specifically in light of the Covid-19-related litigation in South Africa and the United Kingdom. The goal is to address the challenges faced by insurers, regulators, and the judiciary in navigating the complexities of BI insurance and provide a foundation for a more informed and consistent approach to future claims.

1.4 Research questions

This research will address the following questions. Did the demand for a business interruption policy act as a catalyst for the development of this policy? What are the fundamental principles underlying the business interruption policy? What was the basis of the different conclusions reached by courts in different jurisdictions in the adjudication of business interruption losses sustained as a result of Covid-19, where the courts in some jurisdictions found that the policies provided indemnity and others found that the loss was not indemnified by the BI policy? What is the impact of various wordings of the policy on the interpretation and application of the policy? What impact if any, have the FSCA guidelines, the principles of Treating Customers Fairly (TCF) and public opinion had on the decisions of insurers to either pay or repudiate BI claims for losses sustained as a result of Covid-19? It will be submitted that these factors influenced insurers to pay the BI claims in circumstances where the claims ought to have been repudiated.

2 METHODOLOGY, LITERATURE REVIEW AND CONTRIBUTION

2.1 Methodology

The research will be conducted through a study, review, application and development of the relevant literature. It is a qualitative study not a quantitative study. No statistical data has been collected and no interviews were conducted. No surveys or interviews were carried out. Accordingly, and on this basis the application for an ethics waiver was been approved. The research includes an historical explanation of the development of business interruption insurance and archival study thereof. The fundamental principles underlying business interruption insurance will be abstracted and discussed in order to identify the underlying reasoning behind the wordings of business interruption policies, in respect of the main policy, the extensions and exclusions.

Although it is generally desirable to state a research question, sometimes, as in this case, it is more appropriate to set-out a research objective. Various research questions are proposed, which in dealing with the research objective define the progression of the research, and guide the type of challenges to be considered. These thus set-out a methodological framework which follows a progression which allows for the achievement of a research objective.

The objective of the research will be achieved as follows:

- It starts in the 1700's with the realisation that property damage policies do not cover consequential losses
- This leads to the understanding that a market demand exists for insurance covering consequential losses;
- It sets-out the numerous unsuccessful attempts to provide the cover over a period of 100 years;
- It sets out the fundamental principles of accounting for these losses with an insurance framework, enabling the formulation of cover for business interruption losses ;
- It analyses how courts in various jurisdictions have the interpreted the business interruption policy pre Covid-19;
- It examines in light of the Covid-19 claims, the litigation which arose;
- The development which has arisen expressing societal view that this cover should exist for Covid-19;
- The application of the fundamental principles of insurance, to the possible cover which almost certainly concludes that this is probably not possible.

In tandem with this research a series of articles were written and published for information purposes for the industry. These are annexed to this dissertation.

2.2 Literature review

The dissertation does not include a single literature review section, since each chapter reviews and applies the literature appropriate to that chapter.

Much of the information regarding business interruption insurance comes from court cases. It was thus necessary to study these in detail which was done. However not to overburden the flow of the discussion, the detail discussion of the cases have been moved to annexures and only what is necessary for the narrative is included in the body of the dissertation itself.

2.3 Contribution of this study

This study provides a comprehensive explanation of the development of the consequential loss policy, the structure of the policy and a contextual interpretation of the policy culminating with a discussion of the recent litigation. Currently there is an absence of a principle-based exposition of the policy. To achieve this, the dissertation will provide a comprehensive explanation of the consequential loss policy, explains the problem which gave rise to the policy, develop the principles which achieve indemnification against consequential losses, explains how these principles are captured by the policy wording, explains the role of the extensions to the policy, reassess business interruption policies in light of Covid-19 litigation, discuss the judicial interpretation of the policy, discuss the impact of the guidelines made by the FSCA, Treating Clients Fairly (TCF), and discuss the response of public opinion with respect to the litigation. The dissertation provides clarity on business interruption policies and the fundamental principles of business interruption insurance.

2.4 Chapter outline

The remaining chapters unfold as follows. Chapter 3 shows how over a 100 year period attempts were made to design a successful policy. Chapter 4 sets out the principles which if applied will allow for indemnification of consequential losses. It was the understanding of these principles which allowed the successful design and implementation policy. The modern policy thus emerged after a century of failed attempts to provide the cover. The success came once the fundamental principles were understood. Chapter 5 shows how these principles are captured within the wording of the policy to create the business interruption policy. It

continues to explain why extensions are necessary to provide consequential loss cover. Chapter 6 considers the manner in which the judiciary has interpreted the policy, from early cases, prior to the South African, UK and American cases which arose as a consequence of Covid-19. In Chapter 7, the existing textbook will be critically discussed, and it will become evident that the textbook does not provide a background to the fundamental principles underlying consequential loss policies and focuses largely on the accounting and practical issues as to how to calculate the consequential losses sustained. It will also argue that to the limited extent these works discuss the business interruption policy, the discussion is misleading. Chapter 8 includes a final discussion on whether or not and how Covid-19 risks can be insured. Chapter 9, the FSCA guidelines and Treating Clients Fairly is discussed: how did these impacted on insurers during Covid-19, and whether these affected the insurers with regard to their social responsibility to pay claims for business interruption losses. The issue of public opinion and pressure will be considered Finally, Chapter 10 provides an overview and will make conclusive comments regarding the research and the future of cover for business interruption losses.

3 HISTORICAL ATTEMPTS TO PROVIDE COVER FOR CONSEQUENTIAL LOSSES

3.1 Introduction

Property is exposed to a variety of perils, for example, fire, natural disasters, impact damage, vandalism, theft and so forth. Perils operate is such a manner as to result in accidental loss or damage to the property. The property damage policy provides indemnity against the actual damage and loss sustained (Elton, 1915; McKinsey and Co, 2020). It does not provide cover for consequential losses, legal liability losses or for pure financial losses. This results in the insured being exposed to losses which are not covered by property damage policies.

On the other hand, that consequential losses arise from accidental events has been understood for a long time. For example Paul the Jurist (fl. 222–235 AD), in the *Roman Digest,* recognised that a wrongdoer should be held liable for causing injury or damage to others or their property and then continued. "Furthermore, other heads or damage necessarily connected [to the damage itself] are taken into account". He stated further: "…not only must a valuation be made of the object destroyed [property loss], but it must also be born in mind how much value of the others had been lessened" (Vivian, Spentzouris & Taylor, 2021a). The lessening in the value is an example of a consequential loss. The development of the consequential loss policy is discussed below.

3.2 Development of the insurance market

3.2.1 Marine Market

The oldest form of insurance is marine insurance. Marine insurance can be traced back to ancient and medieval times when associations, societies and guilds, provided funeral benefits and other financial assistance to members of these entities (Risk Engineering; Fukuyama, 2011). People sold goods in their own villages and over time started trading with neighbouring villages. In economies where no formal financial instruments existed, non-monetary economies exist. In these economies, "insurance" types of assistance existed on a mutual aid basis. Mutual aid was utilised to protect against loss. Financial transactions did not exist, did not cover the loss, but there existed a system of barters and exchanged of services, which would occur if an adverse event occurred (Beattie, 2021).

Methods of transferring and distributing risk were employed by the Babylonian, Chinese and Indian traders as early as 3 millennia B.C (Fukuyama, 2011; Beattie, 2021). The Chinese traded their goods across rapids, they transported their goods in many vessels to avoid loss of all the goods in the event that a vessel capsized. This was one of the first examples of the transference and distribution of risk. The Code of Hammurabi (1754BC) was followed by the Babylonians, which was also followed by early Mediterranean sailing merchants. Merchants who received loans to fund their cargo, in order to purchase a guarantee to fund losses of their goods being transported, would pay an additional amount as 'insurance' to cover this loss or damage (Beattie, 2021).

During 800 B.C. the 'Rhodian Sea-law' was implemented, which applied to seafarers and merchants. Groups of seafarers and merchants, joined forces to ship their goods together and introduced the concept which is today know as General Average, which was used to compensate merchants who suffered loss or damage during the voyage. It included a provision that in the event that cargo had to be thrown overboard to save the marine adventure, that the loss thereof would be equally shared by the other seafarers. The earliest examples of insurance have been identified on Rhodes, Greece in 1000 B.C.E. Money was advanced in the form of 'maritime loans', where money would not be refunded in the event of the loss of a ship and its cargo. In this event the loan would compensate for the loss of the ship and cargo. Should the ship return safely the loan together with interest would be paid. The pricing of the loans changed depending on whether it was a dangerous time of the year or not. This is indicative of pricing of risk using underwriting similar to insurance (The Prudential Insurance Company of America, 1915; Miteski, 2019).

With the increase of global trade across seas, during the 13th and 14th century, it became evident that there was an increase in the possibility of loss or damage. Trade was expanding from Europe and the demand for the diversification of this risk grew. A Chamber of Assurance was established in 1310, in Bruges (Miteski, 2019). The first insurance contract was written in in Genoa in 1347. In the 15th century the development of maritime insurance grew which had the effect of separating insurance contracts from investments (Miteski, 2019). Policy wording became standardised and knowledge of insurance spread widely throughout Europe.

In 1488 (published in 1552), the first printed book on insurance was published which was the legal treatise *On Insurance and Merchants' Bets* by Pedro de Santarem (Santena) (Franklin, 2001). By the 16th century, insurance became widely used and during the period of Enlightenment in Europe (1685-1815), different specialised types of insurance emerged. During the late 17th century, Edward Lloyd opened Lloyd's Coffeehouse, which became the

prominent marine insurance marketplace in London. This was in an age before office blocks existed and coffee houses were places where business was conducted. The Coffee House was thus not the same as the modern coffeehouse. This marketplace was used by European and American traders to meet to insure their cargo and ships. With other traders wanting to underwrite these ventures, they formed informal agreements at first insuring both cargo and ships. This led to the establishment of the insurance market of Lloyd's of London (Lloyd's Corporate History). In the 18th century, English merchants and shipowners, largely funded their operations themselves, but over time, looked for alternative ways to diversify and looked for mechanisms to assist to cover losses or damages sustained at sea.

The first Danish marine insurance "company" was established in 1726 and the first Norwegian marine insurance company in 1809. The Italians developed rules and regulations known as 'Law Merchant', which rules governed marine insurance globally. (Kingston, 2011).

The purpose of marine insurance is to indemnify against loss incidents arising out of the marine adventure. To the insured, a risk or uncertainty as to loss to which he is exposed, was transferred to another, in exchange for an agreed consideration. Marine insurance was provided by individuals, particularly those assembled in coffeehouses who came to be known as underwriters, since they wrote their names and signatures beneath the wording describing the insured risk, and the proportion of the risk they accept. They thereby provided a personal guarantee for a marine venture. Marine insurance covers the loss or damage arising out of an accidental event, caused by perils of the sea, perils on the sea, and extraneous risks. Perils cause the loss or damage. It only covers actual physical loss or damage to cargo or to the ship. It became clearer as discussed below, marine insurance does not cover consequential losses nor liability claims. Because of the vague wording covering the "marine adventure" with equally vague perils of the seas, and on the sea, it was not clear what the extent of the cover was. Accordingly ships and cargo which are lost at sea, including the cost of transporting the cargo, freight, are covered. But the cost of expenditure is not covered from the sale of the cargo. if the cargo is lost. Insurance would be needed. Lives lost at sea to be covered would need other form of insurance such as liability insurance, where liability claims are instituted as a consequence of a marine adventure (Lloyd's Corporate History). These were not covered by marine insurance.

A marine policy is a policy which covers property losses. The Lloyd's S&G Policy was the most famous form of marine policy, but has since 1982, been phased out and substituted by Institute Clauses. The introduction of *Lloyd's Marine Policy* (the MAR form) and the *Companies Marine Policy of the Institute of London Underwriters* replaced the S&G Policy.

The S&G wording was in use for centuries and in the end the meaning of S & G was no longer clear

In 1906, English Marine Insurance law was codified by the *Marine Insurance Act* (1906). The importance of it being a codification lies in the fact that as a codification of marine insurance, it is an authoritative guide on insurance law in general (Vivian, 2017).

3.2.2 Marine insurance, consequential losses and legal liability claims

Marine insurance per se covers loss or damage to property, vessels, fittings and cargo. It does not extend to consequential losses, legal liability claims or pure financial losses, but as indicated above the actual wording was vague and an attempt was made to recover consequential losses and legal liability claims. This attempt was made in *De Vaux v Salvador* (1836 4 Adolphus & Ellis 420) to obtain indemnity against consequential losses and liability claims under the marine policy both claims were rejected.

In *De Vaux v Salvador* (1836) the insured vessel collided with another vessel on a river voyage. While being repaired it incurred additional wages. This was the first head of damages. The second head of damages arose because of an Admiralty Rule which stated that in the event of an accidental collision, the damages sustained by both vessels were to be added and then divided equally between the two vessels, with each being liable for half of the total damages. The insured vessel had sustained less damage than the other and accordingly was liable to the other for the difference in the loss caused. The insured attempted to recover from the insurers this difference. These were clearly not a property damage claims. Both heads of damage were rejected. The first head of damage is for consequential losses and the second for legal liability claim.

The first head was rejected by Lord Denman on the following basis:

> 'But when we consider the high authority of that great master of insurance law [presumably Lord Mansfield] … and above all, when we find no trace for even a claim being set up inconsistent with it for a period of near 70 years, though the facts must have afforded the opportunity many thousands of times, we think this point must be regarded as fully established, and that we should not be justified in casting any doubt upon it'.

So it is clear that the marine policy, being a property damage policy, does not cover consequential losses. But, because of the vague historical wording this was not clear at the time.

The second head was also rejected on the basis that the rule of Admiralty:

> ‘grows out of an arbitrary provision in the law of nations from views of general expediency, not as dictated by natural justice, nor (possibly) quite consistent with it’.

The court held that the shipowner could not recover from the insurer on the basis that the liability to pay was not based on the proximate cause of the perils of the sea, but that it arose out of the rule of Admiralty.

It is not to say that neither consequential losses nor legal liability risks cannot be covered by insurance, but only they are not covered in terms of indemnity which applies to property insurance. To cover these two risks two additional policies needed to be developed, consequential loss and liability policies. This does not mean the cover needs a separate policy document or insurer. These covers could be provided as sections to a policy. A liability section (operative clause) and a consequential loss section (operative clause) could be included in a single policy document, as happens with motor insurance. As a result of the judgment in *De Vaux v Salvador* (1836), a limited liability section was added to the marine policy. This is the so-called Three-Quarters clause also referred to as the Running Down Clause of the marine policy. The balance of the liability exposure could be covered by a different policy. The marine Protection and Indemnity Clubs (P&I Clubs) which evolved to cover this additional risk are discussed below.

Increased legal liability of shipowners and owners of railroads, resulted because of the promulgation of the British Fatal Accidents Act of 1846 and numerous other Acts. The increase of the number of accidents on the railroads, contributed to the promulgation of this Act, which permitted dependants to institute action against wrongdoers for loss of support. The RDC provided very limited cover against legal liability claims which the marine market was unwilling to cover. This lead to the rise of Protection & Indemnity Clubs. In 1855, the first mutual protection club was formed in the form of the Shipowners’ Mutual Protection Society (now the Britannia Steam Ship Insurance Association Limited). The first indemnity club was formed in 1874, which provided cover for liability for the loss or damage to cargo. Subsequently, the rules of these clubs were amended resulting in the provision of both protection and indemnity. As a point of interest it is pointed out that P&I Clubs do not operate within the SA market and a broker would have to place this cover with an international P&I Club.

Losses brought about by accidents led to the evolution of the accident market discussed below.

3.2.3 Fire and natural perils market

Modern fire insurance developed in Germany in the late 1600's with England following after the Great Fire of London in 1666, which destroyed approximately 13 200 homes, 87 parish churches, the Guildhall, the Royal Exchange and St. Paul's Cathedral (London Fire Brigade). This created awareness about the need for fire insurance. In 1676, the first fire insurance company, Hamburg Fire Office, was established by the Ratsherren (city council) of Hamburg (now in Germany) (Museum of London).

The development of UK fire insurance can be traced back to 1681, just after the Great Fire of London (Museum of London). Nicholas Barbon working in conjunction with eleven associates, established the first fire insurance company- 'Fire Office for Houses'. (Miteski, 2019). After this initial successful launch of a fire insurance company, many more sprung up in the following decades. Initially these companies had their own fire departments as a preventative and mitigatory mechanism to minimise the damage caused to its insured properties. The Sun Fire Office which was started in 1710, is the oldest existing property insurance company (Balor Education, 2013). Fire policies provide indemnification against loss or damage of property from the peril of fire. The Fire policy developed to add additional perils, explosions and natural perils such as earthquakes.

Notwithstanding the birth of fire property damage insurance, modern business interruption insurance only started some 102 years later. Although the market realised that in order to fully protect a business, insuring only physical property was not enough, insurance protecting businesses beyond this type only developed much later. In order to fully protect a business, stockholders' and creditors' investments and the business income must be protected. A high degree of certainty is required by insurers to ensure that they are insuring a genuine loss suffered by the insured, with the principle of utmost good faith underlying every insurance contract.

As in the case of marine, an insured who suffers an insured loss could face consequential losses as well as legal liability claims. Clearly some insureds would try to convince a court the concept of indemnity is broad enough to cover these losses. In the UK, this happened in the case of. In *Wright v Pole* (1834 1 AD & EI 621) the insured inn was destroyed by fire. The insured attempted to recover loss of income suffered as a result of the loss of the inn, his "interest in the 'Ship Inn" -due to fire. He tried to recover not only the amount caused by the fire damage, but his hostelry also suffered, a loss of profit sustained during the period when the inn was being repaired. The court held that the insured could not

recover for the loss of trade or the costs of hiring new premises under a fire policy (MacKen, 1928). The claim for the hire of premises would be classified as increased cost of working.

A further attempt was made in the 1847 case of *Menzies v North British and Mercantile Insurance Company Ltd* ((1847) 9 Duni 694) where the insured tried to recover net profit and standing charges. What was highly disputed was the consequential loss of occupancy during the period when the building were being repaired, the loss of profits during that period and the wages of the employees which the plaintiff paid during the period of dislocation (MacKen, 1928). The court made it clear that indemnification for damage to property must be strictly confined to the damage sustained to the property. It is limited to 'the fabric of the property'. Loss beyond the 'fabric of the property' cannot be recovered under property insurance (MacKen, 1928). The US followed the approach of the UK courts in the case of *Niblo v North American Fire Insurance Co* (1848 1 Sandf NY 551).

These cases of *Wright v Pole* (1834) and *Menzies v North British and Mercantile Insurance Company Ltd* (1847) are important to the development of insurance. They defined the specific parameters of fire insurance, and they identified the demand for cover beyond those parameters (MacKen, 1928). The lacuna was identified and the demand for cover for consequential loss emerged. During the 19th century there were sporadic attempts to develop schemes to provide cover for loss of profits. An example given was that made by the Beacon Insurance Company in 1821, which offered to the public 'the insurance of a weekly allowance to tradesmen and others during the period that are deprived by fire of the means of pursuing their usual vocations' (MacKen, 1928).

Another attempt was made by the General Indemnity Insurance Company in 1853 where as part of its fire insurance cover, it offered the option to add insurance against loss of business profits sustained as a consequence of a fire (MacKen, 1928). No further information is available as to how this insurance was to be underwritten. As stated by MacKen (1928): 'the path of the pioneer is bests with pitfalls, and these early adventures into the realm of Consequential Loss ceased to exists after brief career, and we can only wonder if, and to what extent, their inglorious end was attributable to their experiments in connection with Profits Insurance.'

3.2.4 Accident market

Industrialisation of society led to accidents and accidents led to the evolution of the accident market. Legal liability claims and workmen's compensation formed part of this market. The first company to offer accident insurance in 1848 in England was The Railways Passengers

Assurance Company. Accident insurance was developed much like disability insurance. The company offered cover for rising number of rail-transport and factory injuries, and offered compensation for loss insured as a result of an accident. With regard to accidents sustained in the workplace, this market developed liability policies and the Workmen's compensation movement and employee benefits (Vivian, 2017).

In *Theobald v Railway Passengers' Assurance Company* ((1854) 10 Exch 45), the accident policy did not cover a claim for lost business profits. Two distinct contracts existed in the policy. The first was to pay compensation to the executors of the insured in the event of the insured's death. The second was in respect of compensation for pain, suffering and loss suffered as a result of an accident. The second was a contract of indemnity not the first (Merkin & Nicoll, 2017). It was held that where the policy provided for payment of UKP1000 in the event of the death of the insured, and for the proportionate amount in the event of personal injury, the amount paid for compensation for personal injury, is the actual amount but not exceeding the UKP1000.

3.2.5 Conclusion re property and accident insurance and consequential losses and legal liability claims

The conclusion that can be reached from an analysis of the cases aforesaid, it that 'indemnification in terms of property insurance indemnifies against property losses, and not consequential losses or legal liability claims' (Vivian, Spentzouris & Taylor, 2021a). To cover both consequential losses and legal liability claims additional insurance policies would be required.

3.3 Development and nature of the business interruption market

With the realisation that business interruption losses occurred, and that these could be insured, business interruption insurance evolved, it first emerged in the 18th century, and evolved and matured to cover the demand to cover business losses. . With the development of industry and the evolution of the Industrial Revolution, at the end of the 18th century, risks in businesses significantly increased and were identified. Traditional cover did not provide for the risks which emerged as a result of developing businesses and increased workforces. Accidents in the workforce were not covered by traditional insurance. Whatever the risk is to a business then, be it fire, natural catastrophes, cyber-attacks or political events, there has never been a time when risks are as high as what they are now (Swiss Re, 2004).

The first attempt to provide business interruption cover was in 1797, by Minerva Universal, a UK insurer, which introduced a product which covered a form of consequential

loss insurance covering a company's ability to pay interest as a result of losses to its physical assets (Swiss Re, 2004). The absence of standard accounting principles was the main reason why this form of insurance did not catch on. The concept of this insurance continued to exist and in 1817, it was once again developed into a product. In 1817, the English Hamburg Fire office began to offer loss of rent insurance as an extension to its fire insurance policy (Swiss Re, 2004). Loss of rental income leads to a shortage of turnover (Vivian, Spentzouris & Taylor, 2021c).

This was followed in 1821 with the development of a Time Loss Policy introduced in the UK, also known as the *per diem* system, offering compensation based on a daily or weekly calculation. This system was conceptually an inadequate type of a valued policy (MacKen, 1928; Swiss Re, 2002).

One of the most important aspects of the development of business interruption insurance, is uniform accounting standards. With the commencement of the Edinburg Society of Accountants (formed in 1854), the Glasgow Institute of Accountants and Actuaries (formed in 1854) and the Aberdeen Society of Accountants (formed in 1867), the importance of uniform accounting standards became evident. These three bodies merged into one in 1951, the *Institute of Chartered Accountants of Scotland* (Vivian et al 2021c).

In 1854, with the development of uniform accounting standards, business interruption insurance could also develop. In 1857, Alsace France introduced a cover known as 'Chômage' Insurance, or *systeme forfaitaire,* meaning cover due to factory or labour stoppage or unemployment. In France these insurances were known as the 'Percentage of Fire Loss' insurance, being extremely simple for the public, although inefficient, and as pointed out, are in fact not simple (MacKen, 1928). What became apparent, is that a separate insurance is needed, in order to cover consequential loss caused as a result of fire (MacKen, 1928). An additional fixed indemnity expressed as a percentage of asset's value due to loss or damage was included in the cover (LMI BI Calculator, 2021). The cover provided was on a flat rate with additional cover for stock which would cover a portion of the loss of profits. The concept is similar to that in marine insurance. Settlement for loss is calculated on the basis of CIF + 10% [Cost Insurance Freight +10%]. This concept was first introduced by some insurers in the UK in 1868 (Manning, 2005). In the majority of cases, as pointed out by MacKen (1928), the trading loss caused by fire to the insured premises, cannot 'satisfactorily be measure by the extent of the fire damage'. It further introduced an element of moral hazard. Typical wording used in this type of policy was as follows:

> 'The Insurers will pay to the Assured the same percentage (after due allowance has been made for any salvage) of the sums recoverable by the assured under fire insurance policies covering stock in the premises as the sum insured hereby bears to the total fire insurance covering stock in the premises on the day of the fire'.

American fire insurers introduced a concept, offering a fixed indemnity per day for each day that the insured could not operate as a result of fire. In the USA in 1880, Dalton introduced the expression "use and occupancy", which was terminology used in fire insurance, describing the loss of production which followed a fire. The policy would pay, upon a loss, a *per diem* values, which is different for different periods of the year. These policies limited the payment to the 'actual loss sustained' (MacKen, 1928; Elton, 1915).

In the following years, in 1868, insurers in London offered similar cover to "Chômage" Insurance. Percentage policies were subject of much litigation, and the following are some of the best known decisions (MacKen, 1928):

- *Wylie Hill v Profits & Income:* In 1904, a claim was lodged for an amount calculated on a stated percentage of the sum recovered as a result of fire damage (MacKen, 1928). The case was dismissed, not on the basis of its merits, but as a result of it not being referred to arbitration first.
- *Stavers & Stavers v Mountain:* The case was heard in 1921. The Plaintiffs were successful in this matter, and the Defendants contention that the business was being run at a loss when the insurance was effected.
- *Brunton v Marshall:* The contention on the part of the Plaintiff's was that the policy was a valued contract, and a term thereof was that the insured sum should not be greater than annual profits, should not be applicable. The court held that the insurer was entitled to determine the annual business profits, and the not reduce the amount payable if the risk was over-insured.

Business interruption insurance continued to be known as this until the 1940's. Most of these policies were valued policies, meaning that the basis in which the indemnity was determined was specified in the policy itself. The principle of indemnity was not utilised to determine the amount payable. Generally the insured was covered for one dollar per day for each day that the insured could not operate (Insua & Lewis, 2016). True indemnity for financial losses was not incurred due to an inability to operate was not paid. No attempt was made to align the dollar a day paying to actual losses incurred. As is explained in the attempts above, cover was a fixed amount or a percentage and was in no way aligned to the actual financial loss suffered by a business.

It thus took a long time to develop a workable consequential loss policy, about 100 years. Ludovic MacLellan Mann (1869-1955) in Glasgow [Scotland] in 1899 is credited with developing a workable Consequential Fire Loss Indemnity policy, (later known as Consequential Loss Insurance or Profits Insurance). Mann's system was the forerunner of the British loss of profits system. The Acme Insurance Company established in 1896, seemed to have issued these type of policies and in 1900, transferred its business to the Western Insurance Company (MacKen, 1928). The new form of coverage marketed by the Western Assurance Company, had a key feature that turnover was the basis of the calculation of cover, and covered profit and 'standing charges' of the business (Richie, 2002). In 1906, BI insurance modelled on the UK model, was introduced in Sweden (Swiss Re, 2004). The Profits and Income Insurance Company made a large contribution to the development of general lines insurance and in 1907, the profits section of its business was transferred to the Legal Insurance Company (MacKen, 1928).

Modern profits policies have developed since the contribution of the Acme Insurance Company Policy, although the basic principle that the basis of the loss is determined from the reduction of business income . This remained fundamental to this cover (MacKen, 1928).

Today's accepted principles for consequential loss became common from this point onwards, albeit different names for this kind of cover have been used. These included Consequential Loss Insurance, Gross Profits, Business Interruption Cover, Gross Earnings, or Business Income. These policies tended by nature to be indemnity policies albeit valued policies, and aimed at compensating the insured for actual financial loss. The important point to note is, with all these policies is that they were only triggered when physical damage or loss to the insured property occurs causing the financial loss. However, what is important to note, is that all these policies respond to financial losses originating from actual physical loss to insured property.

In 1910, the regulatory authority in Germany, following machinery breakdown, approved business interruption insurance. This was followed in 1938, by the Gross Earning Policy, introduced in the USA (Swiss Re, 1997, Vivian et al, 2021c). This was a form of business interruption insurance which covered an insured's loss of gross earnings suffered as a result of a disruption caused by physical damage. This still did not provide an adequate solution to the financial loss suffered as a result of the operations of the business being interrupted. In order to provide a product that could satisfy this demand, insurers required accurate and reliable books of account to be held by the insured business. The purpose of this, was to ensure that the claims for loss sustained were reasonable. These necessary standards

were only introduced by accounting and business bodies in the early 20th century. International standards ensuring accurate and transparent reporting are still continuously being developed.

Until 1939, the 'difference method' for calculating insurable gross profit was used to calculate business interruption loss. In January 1939, in the UK, in addition to using the difference method, the additions method was introduced. Business interruption insurance was also developed by Lloyd's by the legendary Cuthbert Heath (Brown, 1980). He designed a product that would bridge the gap between traditional fire insurance and business interruption insurance (Brown,1980). His new product was criticised, on the basis that the policy was opening up an avenue for fraud, as the loss suffered by the insured could not be certainly be quantified. This did not occur and shortly thereafter, it was acknowledged that the product was one that was required.

The first stand-alone independent fire business interruption policy was introduced in Germany in 1956. In 1986, the Insurance Services Office ("ISO") recommended that the gross earning policy form be replaced with the Business Income Coverage form (Swiss Re, 1997), which is still used today. In 1987, Harry Dickinson Snr, introduced "Instant Profits" coverage in Australia, which simplified business interruption insurance with the rate of insured of gross profit agreed in advance. The policy contained no average provisions nor a savings clause (Swiss Re, 1997). In 1989 to 1991, new business interruption wordings were introduced in the UK by the Association of British Insurers ("ABI").

3.4 Conclusion

From the above, it is clear that property insurance only covers losses directly related to the property. It is also clear that an accidental loss event can also result in consequential losses and legal liability claims. These two forms of losses had to be covered by policies additional to the property damage policy. Thus the business interruption policy and legal liability policies were born.

In addition to consequential losses; losses consequent upon damage to the insured property, there are also losses which can be classified as pure financial losses; losses not consequent upon damage to the insured property. These are not covered by property insurance nor by consequential loss policies. Consequential losses and legal liability claims can be covered but separate insurance needs to be arranged to achieve this. And to do this, the fundamental principles of indemnification of consequential loss must be clearly defined and must be the basis upon which these policies are written. The consequential loss policy is thus a valued policy.

As stated above, the term ‘consequential loss’ usually is replaced by the term ‘business interruption insurance’. Consequential loss gives the impression that cover for this loss is provided for every expense or loss caused as a result of an event. The policy as emphasised above, does not provide blanket cover for all unusual losses suffered (Harris, 1973). In the next chapter, an analysis of the principles leading to the indemnification of consequential loss with be undertaken, which clarifies the precise parameters of ‘consequential loss’ or business interruption insurance.

Clearly business interruption policies do not cover risks that may materially affect an insured’s business, coming from external factors i.e. external third parties, or geopolitical risks, cyber-attacks or disruption of the supply chain. Other exposures which are not covered include product recall, terrorism and reputational damage. The demand for more comprehensive and broader covers arising from developing modern risks, grew and the need for new policies additional forms of cover exists.

4 PRINCIPLES ESTABLISHING INDEMNIFICATION OF CONSEQUENTIAL LOSS

4.1 Introduction

The foundation upon which a business interruption policy is the fundamental principle of indemnification. In this case applied to consequential losses. However it must also be borne in mind that from the beginning the courts have accepted insurance is arranged on the basis the policy is a valued policy (*City Taylors*). Consequential losses arise because insured property is lost or damaged and thus cannot be used to produce the income, referred to as the turnover. This property is insured in terms of property insurance, but as noted, this will only indemnify against the costs associated with the property itself and not consequential losses. The consequential loss insurance provides indemnification which is not provided by the property cover. The two polices plus the liability policy provide the more complete indemnity.

It will be submitted and supported throughout this dissertation, that once the fundamental principles are captured into a policy, then the principles are actually forgotten and the issue becomes one of interpretation and application of the policy. This is evident in the fact that the judicial interpretation of the policy focused on the law of insurance and interpretation of the wording of the policies, with little consideration given to the basic principles of business interruption cover. This situation was alluded to by Oliver Wendall Holmes (March 8, 1841 – March 6, 1935), the great American Jurist, when he pointed out that sometimes society faces problems and passes laws to deal with the problem. These laws are so effective, that the problem disappears and then the reason why the laws are promulgated in the first place, are actually forgotten. Then, he warned, that creative imaginations will invent their own reasons why the laws were introduced in the first place. Further, as the years pass so new generations may not understand what it is all about and the document may well acquire a life all its own. It is preferable that policy be interpreted in terms of the principles to reach a correct application of the policy.

The business interruption policy was developed to cover losses incurred. The basis, the point of departure, of determining this loss is the reduction or loss of revenue, over a specific period, the indemnity period. This is compared to the expected revenue which would have occurred had the loss not occurred, the standard revenue. To arrive at the standard revenue the revenue over the previous period needs to be used as the point of departure. The cause of this reduction in turnover is that the income producing property is not available to produce the revenue because it was damaged (Vivian, Spentzouris & Taylor, 2021b). The property damage

property policy insured the income producing property. It does not cover loss of revenue, as it does not over consequential losses. Without at consequential loss cover the reduction or loss or revenue, is not covered.

Measures of consequential loss are fundamental to determine the insured loss. Various methods to measure consequential loss will be analysed (Cloughton, 1985). An important component of the measures which form part of the fundamental principles is the increased cost of working. To ensure indemnification, the business interruption policy would have to include cover for the increased cost of working (Vivian et al, 2021b).

Insurability of the loss of income will be considered particularly considering the systemic risk which it presents, as it is not related to the damage of the insured property. Systemic risk is uninsurable (Berliner, 1985; Hartwig et al, 2020b; Holbsboer, 1985; Richter & Wilson, 2020; The Geneva Association, 2020).

4.2 Measuring consequential loss

In order to determine what the insured is entitled to when dealing with consequential losses, it is important to determine the insured loss. During a period of indemnity, an insured anticipates a determined amount of turnover (T) will be generated. To produce that T, the insured knows that expenses (E) will be incurred. After deduction of the expenses from the turnover, the amount left is the profit (P) earned by the insured (Cloughton, 1985; Vivian et al, 2021b).

The point of departure is to realise that:

Turnover (T)= Expenses (E) + Profits (P) (E1)

Thus over a specific period of time income which a business receives must be adequate to cover the expenses and provide the profit to shareholders.

Expenses are either Fixed or Variable expenses. So for example, rent is fixed but costs of materials used in the production process are variable.

Thus $T = E_F + E_V + P$ (E2)

P is the dependent variable. It is calculated from the independent variables.

So what would happen if say the property was damaged by fire on the first day of insurance and restored on the last day? There would be no turnover and the variable costs would not be incurred. So equation E2 becomes:

Loss $= - E_F +$ (E3)

So instead of making a profit P the insured would suffer a loss of - E_F. To be indemnified, the insured would have to receive an amount necessary to cover the Fixed expenses and the Profit not earned.

If the insured is paid an amount equal to the Fixed Costs and the Profit the position of the insured is then:

Insurance pay out = Profit which would have been earned + cost of fixed expenses.

Once the fixed expenses are paid the insured ends up with the profit which would have been earned.

Accordingly, what is insured is the Fixed costs plus the projected profit. This is referred to as the Insured Gross Profit, which much to the consternation of accountants since bears no resemblance to what accounts call gross profits.

So the above equation (E2) can be written as:

$T = E_V + GP$ (E4)

The insured needs to determine the insured gross profit which is:
Fixed costs + Profits

This method is known as the additions method which was the first method used in 1899.

The same figure can be determined by subtracting the Variable costs from the Turnover. This is the alternative method introduced in 1939, and is known as the differences method.

In reality, it is highly unlikely the loss would occur on day one of the cover and be restored on the last day. And even if it was, the insured may take some time to recover the business lost during the down turn. So, how is the measure of indemnity to be determined in the case of other losses (Cloughton, 1985).

Equation (E4) can be written as:

$$1 = E_V/T + GP/T \qquad (E5)$$

Where the ratio of GP/T is the rate of insured gross profit.

In the event of a loss the insured can estimate what the turnover would have been had the loss not occurred (the standard turnover) and subtract from that figure what the actual turnover was. The difference is known as the Shortage of the turnover. The rate of insurance gross profit is then applied to the shortage and that is what is due to the insured as an indemnity (Vivian & Mushai, 2020; Cloughton, 1985).

It is very unusual that the shortage of turnover will equal the expected turnover. Furthermore, the period of loss seldom coincides precisely with the period of indemnity as specified in the policy. In addition, the loss of production may also be partial and not total. So an alternative equation is required to capture these as follows:

$$T/T = 100 = V/T + ((S+P)) / T \qquad (E6)$$

Where V are the variable charges and S the Standing charges. The calculation above captures the eventuality that a percentage of the turnover produces the Insured Gross Profit (Cloughton, 1985). The ratio (S+P) / T is the rate of the Insured Gross Profit. Accordingly, if 40% of turnover is used by the insured to cover the variable costs, the remaining 60% will cover the Insured Gross Profit (Cloughton, 1985, Vivian et al, 2021b).

It is only after a loss, that the estimated turnover for the indemnity period can be determined. The books of account of the insured will provide the required value of the actual turnover. By deducting the one from the other, the shortage of turnover will be ascertained. The rate of the Insured Gross Profit can be applied to the shortage, and this will confirm the indemnity value (Cloughton, 1985; Vivian et al, 20121b). The above are the basic principles of the consequential loss policy which were first set out about 120 years ago and are applied

as such to this day. Since the policy is a valued policy it is the determined figure which prevails and not the hypothetical figure derived in terms of the concept of indemnity.

4.3 Increased cost of working

The increased cost of working is defined as the additional expenditure necessarily incurred to mitigate or avoid the reduced sales and therefor turnover, caused by the insured physical loss or damage. MacKen (1928) pointed out that this is the 'true trading loss… loss in respect of net profit and standing charges brought about by the reduction or cessation of business'. This is applicable to period of indemnity. The increased cost of working covers the additional expenses incurred to achieve the same turnover which the insured has earned over the period immediately prior to the insured event. The increased cost of working is also limited to amounts expended to prevent the loss of turnover. If the increased cost of working exceeds this amount and additional cover is required, this will be included as an extension to the business interruption policy.

The limit of indemnity for the increased costs of working, can be included in the limit with gross profit or can be specified as a separate limit of liability. The provisions specified in the policy regarding the period of cover, usually extend the same period of cover as the gross profit, to the period for increased costs of working and any additional costs of working covered by the policy. The increased cost of working incurs no loss of Insured Gross Profit, as there is no loss or turnover. However, to enable the insured to achieve the anticipated turnover, the insured has incurred increased expenses, that as a result, affects the profits (Vivian et al, 2021b).

This category includes necessary costs that an insured will incur to restore its operations to normal. These additional costs, save for the cover provided, would erode the Gross Profit:

- Rent for additional premises
- Additional costs of transportation of machinery to alternative premises
- Increased costs incurred when purchasing additional raw material or products from alternative providers
- Outsourcing of production
- Hiring of temporary equipment required to continue production
- Overtime payment to employees
- Employment of additional staff in a different area near temporary premises

To arrive at the Standard Revenue, based on the previous year's revenue adjustments must be made to account for trends of the business and for special circumstances which have

affected the business had the insured event not occurred. An important point to be remembered, is that in practice, consequential loss insurance, places more emphasis on the accounting principles relative to the calculation of the consequential loss, and has omitted to include sufficient consideration of the fundamental principles applicable to the consequential loss policy (Vivian et al, 2021b). These are considered more fully below.

4.4 Problem of insurability

Business interruption due to Covid-19 has highlighted the question of insurability.

4.4.1 Back to basics

In order to ascertain whether an insurance claim falls within the parameters of an insurance policy, the terms and conditions of the policy must be interpreted. The presumption before this can be determined, is that the risk is in fact insurable. Risks must be insurable before they can be insured, and this must be considered on the process of interpretation of the policy. Usually losses are in fact insurable. In respect of consequential loss, as it has been emphasised, cover is linked to the damage of the physical property. Accordingly, the issue of insurability seldom needs to be considered, since physical damage to individual items of property seldom violate the principle of insurability (Vivian, 2020). It is a fundamental question which is never asked in practice as it seldom plays a role. To ensure property damage arises from independent events, civil unrest and war are usually excluded. To cover these correlated kinds of risks special forms of insurance are required hence the formation of Sasria in 1976 which covered the KZN Riots. 'The economic consequences of a pandemic are, *de facto*, uninsurable' (Kessler, 2021). Loss of revenue which is unrelated to the physical damage, could be a systemic risk which is uninsurable (Vivian et al, 2021b).

In order to determine whether a risk is insurable, it is imperative that there is an understanding of how insurance works. Insurance can only work if the risk is pooled and diversified (Kessler, 2021; Klein, 2014). If it cannot be diversified, the risk cannot be insured. Insurance works because payment of the losses of the few are paid by many in the risk pool. Losses that are unrelated to the physical damage, or losses that are universal, are not insurable (Van Hulle, 2020; Hartwig and Gordon, 2020b; Richter & Wilson, 2020; Kessler, 2021).

As emphasised by Vivian (2020), 'the mathematics of gambling and the mathematics of insurance are similar'. He uses the example of a simple gamble when throwing die. The insurer will pay for a loss which is reflected when a specific number is returned. To pay the claim, a premium must be paid. The table he uses for an example, is indicative of principles of insurance. Firstly, the number of claims is close to the expected number thereof. The principle

of the *Law of Large Numbers* is applicable, in that it is indicative of the fact that because there are large numbers of insureds and the claims are independent from another, the expected outcome per insured unit is close to the mathematical expected value. The applicability of the *Central Limit Theory* results in the variance being both symmetrically positive and negative producing a normal distribution (Eeckhoudt, Bauwens, Briys & Scarmure, 1991). Practically the existence of these two theories ensures the existence of insurance. It is only in these circumstances that insurers can confidently accept risks (Vivian, 2020; Kessler, 2021).

Accordingly, risks which are correlated and do not occur as a result of independent events, are not insurable. Losses which are locally correlated resulting from an insured event occurring in a specific area, raise the problem of accumulation (Kessler, 2021). These accumulated risks can still be insured, as the risk can be insured through the international reinsurance system, as the risk is not correlated to losses globally (Van Hulle, 2020; Hartwig and Gordon, 2020b; Richter & Wilson, 2020). It is emphasised that risks are only insurable if they can be diversified through pooling. Risks that are not diversifiable pose the threat of insolvency to the insurer (Eechoudt et al, 1991).

Secondly, insurance also can only work if claims are paid from premiums as claims cannot be paid from capital. Reserves are used to pay claims from abnormal risks which are insured. This addresses the problems of unusual variations in the occurrence and severity of the losses. So for example the Spanish Flu of 1918 caused an un-expected number of deaths which were covered by insurers reserves and reinsurance. The 9/11 losses were covered by reserves. Covid deaths would be covered by insurers reserves. All of these losses were insurable losses as was the damage to the Twin Towers in New York. The KZN Riot losses exceed SASRIA's reinsurance cover and reserves and for the first time since SASRIA was formed the government had to step in as "reinsurer" of last resort. As indicated insurance works because payment of the losses of the few is made by many in a risk pool. It can only work by diversification (Van Hulle, 2020; Hartwig and Gordon, 2020b; Richter & Wilson, 2020). The third point which Vivian (2020) illustrates, is that there are no excessive profits. Competition is the factor which controls and limits the amount of profit which can be earned. Reserves are funded and fund profits and losses respectively.

The fourth point made by Vivian's (2020) example, homogeneous risk pools need to be formed directly as a result of the principle of the *Law of Large Numbers.* The principle ensures that risks are characterised by identification of costly determinable risk characteristics, resulting in reasonably priced insurance. If this is done Pareto Optimality occurs within the risk pools within minimal cross-substitution, so risks with different characteristics do not subsidise

the loss of other insured risks within the risk pool (Schmitz, 2012). The ability of one risk pool to earn profits sufficient to support risks of another unprofitable pool, does not occur. 'So business interruption losses cannot be carried by the motor pool'(Vivian, 2020).

Finally, insurers monitor claims' ratios in order to manage their risks . The *Law of Large Numbers* ensures that insurers are able to do so. If the number of risks are minimal and correlated, claims ratio does not work. As pointed out by Vivian (2020), when uncorrelated events are insured, these risks can be pooled together. The *Law of Large Numbers* secures stability of loss ratio and in these instances, risks can be managed and insured (Eeckhoudt et al, 1991; Schmitz, 2012). Accordingly, 'losses from a pandemic without government intervention could thus probably be insurable' (Vivian, 2020).

4.4.2 Uninsurability of business interruption risks from pandemic

The occurrence of Covid-19 during 2020 has focused attention on the issue of business interruption insurance in a pandemic. Some insurance is not offered by the insurance market because of the fundamental reasons aligned to the nature of risk. 'The economic consequences of a pandemic are, *de facto*, uninsurable'(Kessler, 2021).

As discussed in the introduction above, when risks are pooled, a condition of insurability exists based on the expectation that losses do not occur simultaneously. A pandemic results in losses occurring at the same time over a large geographical area. It is unique given this potential to impact simultaneously as it does (OECD 2020a). Businesses would be all affected at the same time by the same event being the pandemic. National measures taken by governments are taken on global basis all at the same time. E.g. lockdowns. 'The simultaneous 'losses of the many' cannot be diversified and mutualised across risk pools' . The losses which occur as a result of this are accumulated. Insurers cannot carry this loss accumulation. In the case of a pandemic, this is accentuated as the risk is global. Diversification is negated and global reinsurers and insurers suffer the effect of accumulation of losses.

It has been pointed out (Kessler, 2021), that because so much is dependent on the reaction of governments to a pandemic, the risk of business interruption is 'unmodelable and endogenous'. The governmental measures are the factors which affect the losses suffered by businesses. This is the ultimate factor which interrupts business activity. The biggest challenge is that different governments have different strategies and approaches to address pandemics. This is apparent when a comparison is made of the responses of different countries during Covid-19. The result of this is that it is virtually impossible to access risk and accurately determine premium to be paid to cover this risk.

Finally, challenges of moral hazard and adverse selection affect the potential to insure risk of a pandemic. In the case of adverse selection, only the industries most exposed to such risk e.g. hospitality and entertainment, would purchase this insurance. The result of this would be the reduction in the size of the risk pool. In insurance, moral hazard influences the behaviour of the insured, as insurance acts as a safety net. As explained by Kessler (2020), in the event of a lockdown because of a pandemic, moral hazard is created for governments. With the existence of insurance for these events, governments may be influenced in their decisions on how to manage and respond to pandemics. This may result in a reduced responsibility on the part of government when faced with a public health crisis. It may encourage them to implement 'more economically costly measures'(Kessler, 2020).

In the seminal work, Berliner (1985) analysed the criteria of insurability. His approach was simple yet rigorous with a complete set of criteria of insurability. He interpreted dimensions of insurability, which an insurer must individually consider when assessing insurability: Randomness of the loss occurrence, maximum possible loss, average loss amount upon occurrence, average period of time between two loss occurrences, insurance premium, moral hazard, public policy, legal restrictions and cover limits. These are not independent of one another, and 'the insurability of practically each risk coming into consideration can be clearly defined both subjectively and objectively by the system or criteria' (Berliner, 1985). If one criterion is not satisfied, then the risk is uninsurable for an insurer. For a risk to be insurable, all the criterion must be satisfied. In the case of a pandemic, the criterion missing is the randomness of the loss occurrence. As the loss occurred simultaneously globally, the occurrence is no longer random and according to Berliner, is uninsurable as a result of the risk's largeness. He states that the concepts of "large risks" and "limits of insurability" are both subjectively and objectively interrelated, via the criteria of insurability. Berliner's approach influences discourse on insurability, and is used to analyse insurance markets and its products (The Geneva Association, 2020).

The Dutch Association of Insurers provided a different definition of uninsurability: 'it occurs when a prospective policyholder cannot buy the coverage he reasonably needs to combat the adverse consequences of damage resulting from an uncertain occurrence.' (Holsboer, 1995). This occurs when the required product is not available, or if it is available, it does not provide sufficient cover, or, the product is too expensive and unaffordable.

The problem is that pandemic risk affects the whole world at the same time. Governments take steps which affect the normal operation of the economy affecting everyone simultaneously. Businesses are affected as those which are not essential services are forced to

close during a lockdown. The traditional insurance model as considered above, is no longer applicable and cannot be applied during closure as a result of a pandemic. Risks are correlated and diversification is impossible. Berliner has given nine criteria of insurability: randomness of the loss occurrence, maximum possible loss, average loss amount upon occurrence, average period of time between two loss occurrences, insurance premiums, moral hazard, public policy, legal restrictions and cover limits (Holsboer,1995).

Insurance can be provided for pandemic loss, although most business interruption policies are included in cover which provides for physical damage. As long as the insurability conditions are met, cover can be provided. The problem is the issue of diversification. It is a worldwide problem, with huge exposure, affecting all people in all industries. The question is whether insurance can be held responsible for a social problem. The main reason for uninsurability of pandemic risk, is due to the accumulation of losses and the issue of external moral hazard rising from cover for pandemic risk for businesses caused by 'distorted incentives for public policy decisions' (Richter & Wilson, 2020).

4.4.3 Insurability of business interruption due to Covid-19 lockdown

> 'Insurability is not a strict formula but rather a set of criteria, not all of which can be qualified or observed, some of which have trade-offs, and others which change over time. Key criteria for insurability are for risks to be both random and assessable'(Van Hulle, 2020; Swiss Re, 2017).

Pandemic risk is in principle insurable if the criterion exist (Van Hulle, 2020; Hartwig and Gordon, 2020b; Richter & Wilson, 2020). Products have been developed to cover this risk, and the appropriate premiums have been calculated to provide cover for pandemic risk. However, as insurability is complex, it is probable that many of the losses sustained by insureds will remain uninsured. This protection gap will be considered later on in this paper, and suggestions to address this will be made.

The consequences of the Covid-19 lockdown, has led to much debate about whether the lockdown is covered under certain policies. There has been a realisation over the past year and a half, that business interruption insurance with the contagious disease extension includes cover against losses caused by a general lockdown. This was not intentional and many insurers argued the point of the distinction between the Covid-19 pandemic and the intervention of the government in the form of the general lockdown. The former being insurable and the lockdown being uninsurable. What has become apparent, is that policy wording, with the contagious extension which is imprecise, and being unclear as to whether the accumulation risk of

lockdown related business interruption was covered. The conclusion is that these occurrences were underestimated or ignored, resulting in in inadequate quantification and pricing of this risk (Richter & Wilson, 2020). As pointed out by these authors, 'there is severe uncertainty associated with modelling the frequency and severity of a pandemic.'

The losses due to a pandemic, are generally accepted to emerge over a period of time. The issue of moral hazard may arise during this time, when personal and governmental decisions are made to manage the pandemic e.g. the lockdown. The question asked is whether insurance coverage impacts on these decisions, and whether moral hazard is present. As pointed out by Berliner (1985), if moral hazard exists, then the criteria for insurability are not all satisfied and the risk cannot be insured. Following this rationale, if government intervention occurred without consideration of the economic effects of the decision to lockdown, or having considered same, left it for insurance to cover, there is evidently the existence of moral hazard.

Accordingly, leading from this approach, business interruption due to Covid-19 lockdown is uninsurable. The imposition of a national lockdown, therefor may not be a trigger event for a claim under the policy.

4.4.4 Challenges of insurability for insurers in Covid-19 lockdown

Government handling of a pandemic, has a direct impact on businesses and companies. Measures are implemented by government and public authorities to manage the pandemic. E.g. national lockdown and orders restricting the freedom of movement and ability to work. These impact severely on the economy, and reduce supply and demand globally and across a variety of industries.

> 'For insurers to underwrite all of the economic losses resulting from pandemic risk would impose a material solvency risk on the industry and create a potential threat to broader financial stability' (The Geneva Association, 2020).

It is generally accepted that for insurers to underwrite all economic losses sustained as a result of a pandemic risk, would result in the ruin of insurers and cause instability in the industry. Solvency issues will arise, because of the difference between capital levels and the probability and exposure levels of pandemic risk (The Geneva Association, 2020).

> 'The insurance industry as a whole is increasingly confronted with risks where for reasons of principle and capacity doubts arise as to whether they can and should be covered. This increase of risks at the limits of insurability is due to growing social and accumulation problems, advancing technology and concentration of values, increased complexity and exposure of numerous risks.' (Berliner, 1985).

Using Berliner's criteria, the actuarial conditions which are not satisfied and which present challenges are: the risk is not random and independent. The question to be asked is whether the lockdown was accidental and unintentional. The answer is clearly in the negative as the lockdown was a decision taken by government as a means of managing the risk. The loss probabilities are therefore not reliably estimated and do not fall within reasonable limits. Secondly, from the insurer's solvency point of view, it must be ascertained whether the maximum possible losses per event are manageable. If not, then these will be financially ruinous for insurers. Thirdly, the criteria that the average loss per event must be moderate, and in a pool, the risks must be mutually independent, with expected losses, with permissible and acceptable loadings. As considered above, insurability requires a large number of independent homogenous exposure units and losses. Loss probabilities must be large enough to accurately calculate loss probabilities. Without this historic data, it is impossible for insurers to accurately determine a premium payable for the loss. Insurability requires the absence of moral hazard and asymmetric information. The insurer must have the opportunity to mitigate these through product design and underwriting (The Geneva Association, 2020).

From the market-related perspective, the challenges faced by insurers in insuring Covid-19 business interruption losses, is the determination of insurance premiums. These need to cover claims, operating expenses and costs of capital. At the same time, these premiums needs to be affordable for insureds. Cover limits must also be reasonable, and must not 'defeat the purpose of buying insurance' (The Geneva Association, 2020). With no historical data, with details on loss ratios and claims, it is virtually impossible for insurers to determine a premium.

Berliner's (1985) third dimension of insurability, is the societal criteria. This requires that insurance cover provided must be developed in accordance with public policy societal values. They need to be in compliance with the regulatory framework governing insurance industry. The challenge that insurer faced in regard to these criteria, is that much pressure was placed onto insurers during the Covid-19 lockdown, to pay claims for business interruption, notwithstanding the fact that the policy wordings were unclear and the issue of insurability was questionable. This will be analysed more fully below when an analysis ad composition will be made of the various court case in various jurisdictions.

Insurers' were faced with peculiar characteristic of the risk of COVID-19. The risk is endogenous and political, which is mostly driven by government intervention , before, during and after the pandemic. As pointed out by Guillaume Ominetti (SCOR SE), its economic severity varies greatly depending on the following:

- Level of preparedness to manage the pandemic

- Timing of the adoption and implementation of risk management measures to manage the pandemic
- Decisions relating to sectors which continue to operate and those required to close
- Timing and management of relaxation of lockdown levels
- Economic and fiscal measures adopted by government (The Geneva Association. 2020).

It is clear that governments' actions can change, influence and control the extent of the financial burden of a pandemic crisis. Moral hazard challenges are evident when pandemic risk is covered through private insurance. Full economic and financial accountability is not attributed to government agencies who make these decisions. They manage the crisis and are accountable for it, but the full economic implications of their decisions are not borne by them. The gap exists for them to 'misuse private-sector capital'.

Finally, as public authorities handle pandemic risk, it is particularly difficult to model and measure the economic losses resulting from this.

4.4.5 Difference between risk resulting from pandemic and risk resulting from natural catastrophe

Both natural catastrophes and pandemics are evidence of a catastrophic risk, with low frequency and high severity. The difference is that the possibility of a natural catastrophe occurring simultaneously and globally, is unlikely. In contrast, a pandemic as evidenced by the Covid-19 pandemic, unlike previous pandemics, has infected the whole world.

Natural catastrophes do not cause challenges to conditions for insurability. Risk pooling and diversification are available. It is easier to calculate potential risks of a natural catastrophe, which is done through the use of models. Experience from the past is an important element used in the calculation to include in models.

By definition, pandemics differ from natural catastrophes, as they are not localised. By definition they occur over various geographical regions globally. The limitation and assessment of pandemic risk globally is difficult thereby making this risk uninsurable. Pandemics characteristically produce losses which materialise over time (Richter & Wilson, 2020).

The risk of economic losses as a result of a pandemic, is similar to the risk of property damage as a result of war. The same challenges exist: exposure accumulation, limits in diversification, unmodelable in nature, political decisions and their impact and moral hazard (Van Hulle, 2020). The risk of war is a usual exclusion from cover. This is the same reason why so few business interruption due to pandemic policies exist. The government has a

responsibility to cover the cost of economic losses caused by these two events. This will be considered later in this paper.

Insurance provides cover for property being damaged by a peril. It is thus necessary to establish if the insured peril caused the damage. Covid-19 therefor is not a peril as it did not cause damage to the insured property, and accordingly, it cannot be insured. Therefor the question is not whether Covid-19 is insurable, but whether the consequences of the lockdown are insurable.

Apart from the issue of insurability, other challenges regarding business interruption insurance during a pandemic exist.

4.5 Proximate cause

Webster's Comprehensive Dictionary of the English Language defines the meaning of the word 'proximate' as 'immediate'. It then defines 'immediate' as meaning 'closeness in time' or 'having a direct bearing'.

In the late 1700's and early 1800's, Lloyd's of London underwriters were faced with the initial cases involving marine policies and litigated on questions of the proximate cause. The initial marine policies covered vessels and cargo against the 'perils of the seas'. These included grounding, collisions, allisions, and the inrush of water. In numerous instances, many of the claims were in fact caused by acts of negligence on the part of the master or the crew. The peril of the sea itself was as a direct result of that negligence. An example would be if the master or crew were not keeping a proper lookout and failed to see an approaching vessel or failed to see a sandbank. Negligence itself is not a peril and does not cause property damage. It is thus covered unless specifically excluded. Example the negligence of the crew not keeping a proper lookout can colliding with another vessel. The question that had to be considered, is what was the actual cause of the peril? The underlying negligence had to be identified before it could be determined whether the marine policy would be triggered. If it was the negligence of the crewman or master, then the policy would not be triggered, if negligence was excluded.

Insurance provides cover for property being damaged by a peril. It is thus necessary to establish if the insured peril caused the damage. It is emphasised that a peril is something which can cause loss or damage e.g. fire, wind, water, etc. Covid-19 did not cause any physical damage. The loss or damage would have been the loss of life, covered by life insurance, medical expenses covered by health insurance and medical aid schemes and business interruption, which is covered by property damage policies. The question is, was the peril the proximate cause of the damage? The courts who had to make the decisions on these early

cases, relied on the influential treatise called the *Maxims of the Law,* written in 1596 by Sir Francis Bacon (1561-1626). He considered these issues that arose in many of these cases, and attempted to develop rules to assist courts to make decisions in various of these situations. The one such problem was the issue of causation, which is an issue in most branches of the law. His first and foremost rule (*Regula I*) was '*In jure non remota causa sed proxima spectator*,' which translates as, 'In law, one looks to the near cause, not the remote one.'

He wrote:

> 'It were infinite for the law to judge the cause of causes, and their impulsions one of another; therefore it contenteth itself with the immediate cause, and judgeth of the acts by that, without looking to any further degree.…'

In determining what the cause is of the final result, courts are required to consider one link in the chain of events which resulted in the damage or loss . They are required to identify the cause which immediately resulted in the insured loss or damage (Clarke, 1981). In Latin the word proximate means close and the proximate cause is the nearest cause or the cause immediately preceding the end result. In Bacon's view, events further along the chain of events should not be considered.

The theory proposed by Bacon was used to the courts who considered questions of causation under early marine policies. As human error or negligence is the cause of many losses, the reasoning was that if the courts were to follow the chain of events to determine the root cause of every instance where loss is suffered, not many marine claims would have been covered. This would ultimately reduce the economic value of taking out insurance for the perils of the sea.

Therefore, Bacon's view was accepted as the point of departure and initially held that the proximate cause of a loss under an ocean marine policy was the peril that was closest to the happening of the damage. Examples of these cases are :

- ***Busk v. Royal Ins. Exch*** **2 B & Ald. 73 (1818)**

A policy of insurance was effected upon Carolina, a Russian ship bound, 'at and from' Amsterdam, to St Petersburg. A clause in the policy stated that the assured was protected from 'fire, barratry of the master and mariners…'. When nearing St Petersburg, Carolina became fast in ice and, as was the custom in the trade, the master paid off the crew and left the mate in charge while he went to St Petersburg to settle some accounts. On 9 January, the mate lit a fire in the ship's cabin and, later, went aboard another Russian vessel lying nearby to spend the

night there. Early the next morning, the mate was awoken to find that a fire had broken out aboard Carolina and she was destroyed. The owners of Carolina claimed on their policy of insurance, and the question before the court was whether the loss was covered in view of the mate's actions in lighting the fire and then not remaining on board. The court ruled that, the insured peril was fire and the loss was still by fire. The negligence of the mate did not change the fact the loss was caused by fire, Bayley J stated [p 80] :

> '…In this case, however, the loss is occasioned by fire, against which the assured is protected by the terms of the policy; and, in our law at least, there is no authority which says that the underwriters are not liable for a loss, the proximate cause of which is one of the enumerated risks, but the remote cause of which may be traced to the misconduct of the master and mariners…We must, therefore, endeavour to collect the meaning of the contracting parties from the terms of the policy itself, and in considering whether the assured claiming for a loss by fire, is to have the claim disallowed, on the ground that the fire was occasioned by the misconduct of the master, we must look to the other terms of the policy, and learn from them, whether the assurers, in other instances, are responsible for the misconduct of the master; and when we find that they make themselves answerable for the wilful misconduct of the master in other cases, it is not too much to say that they meant to indemnify the assured against fire, proceeding from the negligence of the master and mariners. I am therefore of opinion in this case, that the assured are entitled to recover, as for a loss by fire, although that fire was produced by the negligence of the person having the charge of the ship at the time…The owner certainly is bound, in the first instance, to provide the ship with a competent crew, but he does not undertake for the conduct of that crew in the subsequent part of the voyage…I therefore think that the plaintiff, upon the facts stated in this case, was entitled to recover…'

- ***Howard Fire Ins. Co. v. Norwich & N.Y. Transp. Co.*, 79 U.S. 194, 20 L. Ed. 378 (1870)**

The Howard Fire Insurance Company insured the steamer Norwich, owned by the Norwich and New York Transportation Company, for $5000 against fire. The steamer was covered for damage to her hull, boilers, machinery, tackle, furniture apparel by the policy. Cover included whether she was stationery or moving, running or not running. She was insured against all loss or damage, not exceeding the amount insured, should the damage be caused by fire, any invasion, insurrection, riot or civil commotion, or any military or usurped power. On one of her regular routes between Norwich to New York, a collision occurred between her and a schooner. The schooner collided with her on her port side and damaged her hull below the water line. The result being that water started flooding into her hull. The water rose rapidly and within a few minutes, the water reached the floor of the furnace and this resulted in a fire ensuing which continued to rage on for over half an hour. She gradually sunk in twenty fathoms of water and capsized. The construction of the steamer was such that her main deck was accommodated from stem to stern, up to the promenade or hurricane deck above. The freight

was sowed on the main deck. The cabin and staterooms were also on hurricane deck. It was determined that the collision on its own who not have caused the steamer to sink below the promenade deck. She would not have sunk but would have been suspended in the water, towed to a place of safety and would have been repaired. The repair and restoration in this event would have amounted to $15,000. However, the sinking of the steamer below her promenade which was caused by the fire, damage the damage and much of it was lost as it floated away. This contributed to the sinking of the steamer . The damage that was suffered over and above the $15,000, was an additional $7,300, which included the costs of raising the boat . The Transportation Company claimed for indemnity against the insurer, for loss by fire within the policy, which claim was repudiated. The case was heard by the Circuit Court, which found in favour of the plaintiff. The Insurance Company appealed the decision with the aim of reversing the judgement.

Mr Justice Strong gave the judgment in this matter.

> ‘There is, undoubtedly, difficulty, in many cases, attending the application of the maxim, " proxima causa, non remota spectatur," but none when the causes succeed each other in order of time. In such cases the rule is plain. When one of several successive causes is sufficient to produce the effect (for example, to cause a loss), the law will never regard an antecedent cause of that cause, or the " causa causans." In such a case there is no doubt which cause is the proximate one within the meaning of the maxim. But, when there is no order of succession in time, when there are two concurrent causes of a loss, the predominating efficient one must be regarded as the proximate, when the damage done by each cannot be distinguished. Such is, in effect, Mr. Phillips's rule. And certainly that cause which set the other in motion and gave to it its efficiency for harm at the time of the disaster must rank as predominant. In the present case, however, the rule hardly seems applicable, because the damage resulting from the fire and that caused by the filling of the steamer are clearly distinguished’.

- ***Queen Ins. Co. of Am. v. Globe Rutgers Fire Ins. Co.*, 263 U.S. 487, 20 L. Ed. 738 (1924)**

(Holmes, J.) "[T]he common understanding is that in construing these [ocean marine] policies we are not to take broad views but generally [we] are to stop our inquiries with the cause nearest to the loss."

As is evident from the case law, the rule of proximate cause may be interpreted in two distinct and different ways, and this dilemma has been reflected by the courts until 1918, when *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* ([1918] AC 350, HL) was decided. This case was also relied upon in the *FCA v Arch Insurance* [2021] UKSC 1 in consideration of the proximate cause.

In the *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* case a ship was torpedoed but did not sink. It had a gaping hole in its side. Clearly this is a war risk and needed to be covered by a war risks policy. The war risk could still be a peril of the sea. As indicated above war losses are correlated and thus generally uninsurable but can be covered under limited circumstances. The damaged ship limped to the nearest harbour and arrived their safely. The harbour master would however not admit the ship into the harbour fearing it would sink in the harbour mouth blocking the harbour. It was thus forced to anchor outside of the safety of the harbour. While there a massive storm blew up and the ship sank. So in this case what is the proximate cause of the ship sinking:

- The act of the enemy in which case the peril is the peril of an act of war
- The action of the harbour master
- The storm?

The action of the harbour master is not a peril – that as indicated above is too remote to be taken into consideration. So for purposes of property insurance that can be discounted.

The most immediate cause is the storm, a peril of the sea and thus if Sir Frances Bacon's approach was strictly followed the conclusion would be the sinking was the storm and not an act of war. The court however declined to endorse that view and resorted to the effective cause of the loss which is still in operation at the time of the loss. Taking this approach the cause of the loss could be the act of war. It has been strenuously argued that the 1918 changed the narrow approach to proximate cause and subsequent to the 1918 decision courts have indeed taken a broader approach to causation (Clarke, 1981).

It should be clear why the *Leyland Shipping* case was attractive in the Covid litigation. It can be argued the peril in the contagious disease extension is Covid-19. Losses arose because of the lockdown and the lockdown is not an insured peril. But it could be argued the effective cause of the lockdown was Covid in the same sense it could be argued the effective cause of the sinking of the ship was not the storm but the earlier act of war.

This argument has some validity when dealing with the contagious extension to the BI policy but has no validity when dealing with the main policy. In the main policy the peril is damage to the property. If the insured property is not damaged, the policy is not triggered.

4.6 Conclusion

In conclusion, the importance of the principles leading to indemnification of consequential loss, is that these principles are fundamental in determining the insured loss. But since the BI policy is a value policy, the extent of a method of determining that indemnity is set out in the

policy itself. To secure indemnification of consequential loss, cognisance must be kept of the principles as discussed in this chapter. The principles discussed lead on to define the wording to be used in the consequential loss policy to ensure that the specified indemnification can be provided. As will be discussed below, the UK and SA courts when dealing with the Covid-19 cases, place much reliance on the interpretation of the extensions to the main policy and to the law of insurance; for example proximate cause. By omitting to pay adequate attention to these principles, they were undermined, and it will be submitted, that the incorrect decisions could be reached if applied to the main policy.

5 CAPTURING THESE PRINCIPLES WITHIN THE WORDING OF A POLICY

5.1 Insurance and pandemics

The first line of defence when individuals and companies suffer loss, is to turn to their insurance policies for compensation for loss suffered. Covid-19 pandemic has highlighted challenges faced by insureds when claiming in these circumstances. When the pandemic hit during 2020, many affected businesses, which submitted claims, ascertained that their existing property policies did not cover for the pandemic through the business interruption insurance.

Business interruption factually is not a general perils policy. The general perils policy is the underlying property damage policy, which provides cover for physical loss or damage to the insured premises from specified or all-risk (sic) [perils] basis. In the event that the insured premises suffered physical loss or damage caused by an insured peril, with the damage to the property resulting in a shortage in turnover, cover is provided for such loss or interruption of the business. The peril insured by a business interruption policy is the loss of business caused as a result of the loss or damage of the insured property. The revenue losses sustained in the interruption of the business caused as a result of the of the physical loss or damage to the property are insurable, as indicated above, but are not insured under property insurance (Berliner,1985; Hartwig et al, 2020a; Hartwig et al, 2020b: Hartwig et al, 2020c; Holbsboer, 1995; Kessler, 2021). In order to cover these consequential losses, a specific policy for consequential loss is required which covers the peril of the loss of revenue caused by damage to the insured property (Kessler, 2021; The Geneva Association, Oct 2020).

Business interruption insurance is triggered by the occurrence of the insured peril resulting in the direct physical loss or damage to the insured property (Elton, 1915; McKinsey and Co, 2020). This is the usual requirement that the physical damage is covered by the main policy. Contagious diseases such as Covid-19, would not ordinarily be covered under a standard business interruption policy and if covered it will be in terms of an extension to the policy. In the case of the global event of Covid-19, government intervention in the form of mandatory lockdowns and voluntary closures, with the intention of reducing human-to-human transmission, where the premises are undamaged, this event would not ordinarily be covered in terms of the main policy. To provide cover for this event, a specific extension would have to been included in the policy. Often, certain policies specifically exclude cover for viruses and other health crises (NAIC, 2020; OECD, 2020a; OECD, 2020b & OECD, 2021).

Extensions for coverage for communicable and infectious diseases, and specific pandemic-type coverage are required, which became evident with the various outbreaks of Ebola earliest during 1976, Asian Flu and Zika, prior to the global outbreak of Covid-19. BI insurance is 'by far the greatest loss of income line', and there is a shortage of historical data in respect of business interruption premiums and claims (Swiss Re, 2004). A problem which compounds the lack of data, is that business interruption is usually combined with property insurance policies, resulting in it being difficult to analyse premiums, liability limits and deductibles (Swiss Re, 2004). In emphasising the importance of business interruption insurance, as early as 2004, Swiss Re noted general assumptions in respect of BI insurance:

- 'Fire business interruption insurance is by far the most popular form of loss of income insurance, followed by machinery business interruption insurance.
- Business interruption policies are common in the industrialised countries, especially in big industry.
- Business interruption insurance accounts for less than half of the premiums and losses in the property insurance line.' (Swiss Re, 2004)

Historically, there is not a lot of experience globally with insurance and pandemics. There is heightened awareness arising from recent viruses, but very few policies have been designed and few of these have been purchased, which cover the perils of pandemics. Pandemic threats occur about three times per century (Van Hulle, 2020). The challenge with pandemics, is that they affects the whole world simultaneously. As we have witnessed with the Covid-19 pandemic, governments implemented certain measures to mitigate the effect of the pandemic. These measures affected the normal operation of businesses, of the economy and the society. Globally, measures taken by governments were similar and all implemented simultaneously. The traditional business model of insurers for the diversification of risk within risk pools was challenged with the occurrence of systematic, similar and correlated risks. Diversity of the risk was impossible as most countries globally were affected by the pandemic (Van Hulle, 2020).

Coverage of pandemic risk is uninsurable for this reason. Further, the consequences of pandemic risk are not only difficult to identify and quantify, but also do not fall in line with the risk appetite and tolerance of the insurer. The lack of data of the consequences of pandemic risk, is an additional factor adding to the difficulty facing insurers when considering to provide cover. The problem of insurability relates to a set of criteria, which are not necessarily quantifiable and which are for risks, which in the case of a pandemic, are not random and assessable (Swiss Re, 2017). For the principle of the 'Law of Large Numbers' to work, the

insured event must be unpredictable and independent. In the case of the Covid-19 pandemic, events were highly correlated, exposing insurers to systemic risk. Diversification of this risk was impossible which emphasised the problem of insurability (Van Hulle, 2020; Hartwig and Gordon, 2020b; Richter & Wilson, 2020; Kessler, 2021; Eeckhoudt et al, 2021) .

Compounding the problem of insurability, is the problem of the lack of consistency in the use of policy wording and the interpretation of policy wording. Claims for business interruption for the Covid-19 pandemic have been submitted globally (Gurses, 2021). Claims by policyholders relating for business interruption losses due to Covid-19, have been submitted in terms of two types of policies. Standard business interruption insurance, which covers damages sustained to underlying physical damage, and the resultant loss of business. In South Africa, most of the policies relating to business interruption are these type of policies. Insurers have repudiated these claims on the basis that Covid-19 does not cause physical damage to property and that the closure of business and loss of business was due to the government lockdown. On this basis, claims of this nature have been repudiated.

A second type of business interruption policy, is one where a policy is extended for infectious or contagious diseases, within the insured business and its area of operation. The closure of the business due to such notifiable disease, resulting in loss of business would be covered under such policy. The challenges raised with the interpretation of various policy wordings and the cases which deal with these, will be analysed in depth later on in this paper.

The important issue in respect of business interruption policies which will be considered, is the issue of causation. A prerequisite in a contract of insurance for cover to be provided for loss or damage, is that such loss or damage is caused by the peril insured. Any peril excluded will not be insured under the policy (Vivian et al, 2020). A legal connection between cause and consequence must be established, ensuring that the causal link is finite and is the proximate cause of the consequence i.e. loss. The question that will be considered is whether the loss caused to businesses by Covid-19, is a loss covered in the operative clause of the policy. In order to determine whether Covid-19 is a peril covered and whether this is the cause of the loss, the issue of causation must be considered. The extent to which the elements of causation in the event of Covid-19 and lockdown satisfy the requirements of causation will be challenged.

Sir Francis Bacon's concept of proximate cause as stated in '*maxim iure non remota causa sed proxima spectatur'* has been considered above. The criteria for deciding whether the

event of Covid-19, or government lockdown was the proximate cause of businesses sustaining losses in the form of business interruption will be considered further.

5.2 The main section of the standard policy

5.2.1 Operative clause

Insurance provides cover for what the insured had loss and specifically covered under the policy. Indemnity is the most fundamental principle of insurance law as stated in the case of *Casetllian v Preston* (QBD 1883 11 CA 388):

> 'The very foundation, in my opinion, of every rule which has ever been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy (and that equally applies to accident policies) is a contract of indemnity only, and that this contract means that the assured, in a case of loss against which the policy has been made, shall be fully indemnified, but shall never be more than indemnified. That is the fundamental principle of insurance and if ever a proposition is brought forward which is at variance with it, that is to say, which will give the assured more than a full indemnity, that proposition must certainly be wrong.'

This principle was followed in South African law and it is generally accepted that only the commercial value of what loss has been sustained as a result of an insured occurrence, can be recovered under an indemnity insurance policy (*Nafte v Atlas Assurance Co,* 1924 WLD 239). The most single important clause of an insurance policy, is the operative clause, which specifically defines what is covered and is the trigger for cover (Glynn, Taylor & Nock, 2020; Vivian & Mushai, 2020). The key requirements to be included in the operative clause include: the damage covered, the insured premises used by the insured, for the purpose of the business carried on by the insured and confirmation of premium and cover provided.

Typically pandemic and infectious disease risks are not covered under standard insurance cover, let alone in the standard policy wording or operative clause for business interruption. In order to cover a claim, the particular wording of the policy must be specific enough to determine whether an insurance policy will respond. As is evident with the onset of Covid- 19, and the submission of claims for loss sustained because of the interruption of business because of the lockdown, even if policy wordings do relate to pandemic and infectious disease in a business context, it may occur that the policy will not in fact respond to a business interruption claim arising out of this present context. In order to ascertain whether a claim will be covered by the policy in question, the policy wording has to be carefully interpreted to determine whether the facts giving rise to the claim, are ones envisaged by the policy wording. The question of interpretation and policy wording will be analysed more fully in this paper.

The uncertainty of the interpretation of policy wordings in respect of business interruption claims, has been an issue that insurers, insured and regulatory authorities globally have been dealing with and considering since the inception of the Covid pandemic in 2020. Regulators like the Financial Conduct Authority of the United Kingdom (FCA) and the Financial Sector Conduct Authority of South Africa (FSCA), have published statements regarding declaratory orders and guidelines, in an attempt to provide clarity and certainty relating to business interruption insurance cover. Further, they have attempted to clarify uncertainties relating to the application and interpretation of policy wordings of business interruption clauses. Numerous disputes have been referred to courts, with the purpose to trying to clarify the meanings of the policy wordings which have been used and to obtain guidance on the way forward on how to manage these claims. These are fully considered in Chapter 8 below.

The business interruption policy is difficult to navigate as stated by the SCA in the *Santam v Ma Afrika* (255/2021) [2021] ZASCA 141 (SCA)) case. To do so, it is imperative to understand the structure of the policy. The MultiMark III (MMIII) industry supported policy is a single policy document covering a wide range of individual 'policies', called sections. The MMIII policy has many classes of insurance combined into one policy and the printed wording alone (that is excluding the policy schedules) runs into well over 100 pages. There was no stipulation that any insurer or intermediary is compelled to use the MMIII wording in so far as small business insurance was concerned. Numerous insurers did not in fact adopt the MMIII framework. Concerns arose regarding the practice of using one framework and it has been viewed as anti-competitive. As there is no obligation to use the MMIII framework, and no prohibition from amending the cover provided from the industry accepted standard wording, it is difficult to identify the anti-competitive nature of MMIII. In addition, rates and fees are not dictated in this policy (Vivian et al, 2022a).

The insured selects individual sections or 'policies' to get the total desired cover. Accordingly, the 'business interruption policy' is only part of the policy, the business interruption section. The business interruption section is included in an extension to the policy. What will be shown is that the cover of consequential losses arises from the unavailability of the insured property to produce the revenue which produces the profit because of physical damage covered by a property damage policy. It may be complex, but it will be clearly stated in the discussion below (Vivian, et al, 2022a).

The fundamental part of an insurance policy is the clause which describes the parameters of the cover of the policy. The insuring or the operative clause in a policy provides qualification or the scope of indemnification provided by the policy. The operative clause broadly explains the cover provided, which cover is subsequently qualified and restricted by exclusions, terms and conditions. It's scope is further extended by extensions to the policy. The business interruption section as pointed out by Vivian et al (2022a), is not captured in a business interruption section. The business interruption section is contained in the body of the MM III policy, which in itself is a difficult policy to navigate and requires expertise to fully understand it. The operative clause at the beginning of the MM III policy states the following:

> '… in consideration of … payment of the premium … the company [i.e. insurer] … agrees to indemnify the insured …in respect of the **defined events** occurring during the period of insurance …'

Indemnification will only be provided if the defined event occurs during the period of insurance. The important clause then to consider is the clause defining the insured event which is in the business interruption section itself.

> **'Defined event**
> Loss following interruption of or interference with the business in consequence of damage occurring during the period of insurance at the premises in respect of which payment has been made or liability admitted under:
>
> (i) the fire section of this policy
>
> (ii) the buildings combined section of this policy
>
> (iii) the office contents section of this policy
>
> (iv) any other material damage insurance covering the interest of the insured
>
> but only in respect of perils insured under the fire section hereof (hereinafter termed Damage).
>
> Liability shall be deemed to have been admitted if such payment is precluded solely because the insured is required to bear the first portion of the loss.
>
> The company will indemnify the insured in accordance with the provisions of the specification hereinafter set out.'

It is important to note the following words: 'loss following interruption … in consequence of damage…at the premises.' The wording indicates that the business

interruption policy is a perils policy with the peril being "… in consequence of damage … at the premises …" . The loss following a fire or following Covid-19 is not indemnified in terms of the property policy. The cause of the revenue loss is as a consequence of the physical damaged sustained to the insured property which interrupts the business of the insured. The liability of the insurer is that as admitted in accordance with the terms of the property damage property (Vivian et al, 2022a). 'The cover of consequential losses arising from the unavailability of the insured property to produce the revenue which produces the profit because of physical damage covered by a property damage policy. It may be complex, but it is stated as clearly as it can be stated' (Glynn, Taylor & Nock, 2020; Vivian, et al, 2022a).

5.2.2 The insured gross profit

The Insured Gross profit is as the Turnover less Variable Charges or S + PbT. The impact of loss or damage to income producing property, is that turnover is affected and is either lost or reduced. The value of the loss or reduction of turnover is determined from the insured's financial statements. To determine what the turnover would have been, had the damage not occurred, an estimation must be made thereof based on the financial statements. The actual reduced turnover can be deducted from the standard turnover and the estimated loss of turnover can be determined.

Loss of turnover = Standard Turnover – Reduced turnover

The amount to be paid as indemnity for the loss in turnover = Loss of Turnover * Rate of Loss of Gross profit (Vivian et al, 2022a).

The above is reflected in the typical wording below:

> 'In the event of such direct physical loss or physical damage, the Insurer shall be liable for the loss of [Insured] Gross Profit due to:
> (a) Reduction in turnover and (b) increase on cost of working and the amount payable as indemnity thereunder shall be:
> (i) In respect of Reduction of Turnover: the sum produced by applying the Rate of Gross Profit to the amount by which the Turnover during the Indemnity Period shall, in consequence of the physical damage, as covered by this policy, fall short of the Standard Turnover;
> (ii) In respect of the Increased Cost of Working: the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the Reduction of Turnover which but for that expenditure would have taken place during

the Indemnity Period in consequence of the physical damage, as insured by this policy, but not exceeding the sum produced by applying the Rate of Gross Profit to the amount of the reduction thereby avoided;

Less any sum saved during the Indemnity Period in respect of such of the charges and expenses as may cease or be reduced in consequence of the physical damage insured under this policy.'

5.2.3 The calculation loss of turnover

To calculate loss of turnover, the indemnity turnover is the basis for such calculation.

The turnover during the period of the indemnity is determined. Because of the damage to the property, it falls short of what the turnover would have been had the damage not occurred. So, an estimate must be made of what the turnover would have been had the loss not occurred, the standard turnover. This is arrived at by looking at the actual turnover the same period during the previous year (MacKen, 1928; Vivian et al, 2022a).

A further adjustment is made to account for and made necessary adjustments for special circumstances and trends in the business. These are dependent on the nature of the business insured. Business owners attempt to obtain an uplift based on anticipated business growth. E.g. a new lucrative contract, increased demand for the goods or service or new marketing initiatives. Insurers, conversely, seek an adjustment downwards. E.g. reduction in turnover because of depopulation in the area, which is what happened after Hurricane Katrina. The argument for deferral or turnover is also raised by insurers, stating that there is no loss of turnover, but it is merely deferred until the business is operational again (Glynn et al, 2020; Vivian et al, 2022a).

The financial accounts for the two years immediately preceding the damage or loss are relied upon, to apply the trends clause. A further complication is added in policies for manufacturers. The definition of gross profit usually includes a further adjustment for cost ratio for the business changes which occur year- on-year. If the cost of manufacturing the goods has increased, the gross profit will be less. The converse is also applicable (MacKen, 1928; Vivian et al, 2022a).

5.2.4 Increased cost of working

Another important aspect to consider, when determining the cost of working brought about by the damage to the insured property, is the increased cost of working. It is defined as the additional expenditure necessarily incurred to mitigate or avoid the reduced sales and therefor turnover, caused by the insured physical loss or damage (MacKen, 1928). This is applicable to period of indemnity. The increased cost of working is also limited. If the increased cost of

working is unlimited, this will be included in the extension to the business interruption policy (Vivian et al, 2022; Glynn et al, 2020).

The limit of indemnity for the increased costs of working, can be included in the limit with gross profit or can be specified as a separate limit of liability. The provisions specified in the policy regarding the period of cover, usually extend the same period of cover as the gross profit, to the period for increased costs of working and any additional costs of working covered by the policy (Vivian et al, 2022a). The calculation of the insured gross profits is a challenge in determining the coverage of the business interruption policy, but there are others. The next aspect to be considered is the period of indemnity.

5.2.5 Period of indemnity

The period of indemnity is defined by Macken (1928) as 'the period after any fire during which the business is interfered with, but not exceeding … Consecutive calendar months from the date of such fire.' The period of indemnity is distinguishable from the term of the insurance (Macken, 1928; Glynn, Taylor & Nock, 2020). The period of indemnity is important as it defines the period for which insurers will provide cover to the insured for the losses sustained because of the insured event. Although the term of insurance on an annual policy will be for a year, the period of indemnity can be for longer than a year, which period would depend on the length of time it would take to restore or rebuild the insured premises damaged because of the insured event (Glynn et al, 2020).

In gross earnings policies, the inclusion of the period of indemnity at inception of the policy is a requirement. The purpose is to ensure at inception that adequate provision of cover is agreed upon to ensure that the insured can reconstruct its business and recover trading and profit levels to those levels which existed prior to the loss having occurred (Macken, 1928). It is essential to determine the anticipated recovery time for both gross profit and gross earnings polices (Marsh, 2015; Glynn et al, 2020). The premium payable for the period of indemnity will depend on the length of time agreed upon by the insured and insurer. It is clearly important to ensure that the time agreed is sufficient to enable the insured to restore the damaged premises to the state it was in prior to the damage caused. 'It should be noted that, from the point of view of the operation of the policy, the period of indemnity is the period, within the stated maximum, *during which the business is affected by the fire'* (Macken, 1928).

There are several factors which must be considered when determining the appropriate period of indemnity. These factors have a direct impact on physical reconstruction and recovery

time of the insured. Marsh (2015) pointed out the following factors to be considered when assessing the time required for an insured to return to normal business and profit levels:

- 'Where there are long delivery times for materials or specialist machinery that needs to be replaced.
- When the business is carried out in property – for which the insured is either a tenant or owner – that would take a long time to rebuild as a result of its scale, location, or other factors (such as historic listing or planning restrictions, for example).
- When the company is highly dependent on a few customers – loss of a single customer can have a significant impact, and gaining replacement customers can be a lengthy process'.

It is easy to identify the period from which indemnity will commence, often being a specified period after the insured event occurs, often including a waiting period of a few days. The more complex question is when the period of indemnity will end, and how long is the insured covered for business interruption losses. In cases where there has been physical damage or loss to the insured property, the calculation of the period of indemnity is based on a reasonable assessment of how long the repairs or restoration will take to be completed (Glynn et al, 2020). The wording of policies usually uses the wording 'should be repaired' to define the period of indemnity. Should the repairs take longer than reasonably anticipated, then the indemnity does not extend for this period (Raznia, Slania, 2021; Glynn et al, 2020).

When Covid-19 business interruption claims arose, the question of the period of indemnity became relevant. Business interruption insurance as has been discussed above, usually is provided as an extension to physical loss or damage to insured premises (Raznia, Slania, 2021). In the case where there is no physical loss or damage, and there has been no assessment of the period of indemnity, how would the period of indemnity be assessed? This question arose in the South African cases and will be discussed below.

5.2.6 Extensions to the BI policy

To provide cover for business interruption losses, the main policy usually contains a number of extensions. The need for extensions is obvious. Take the example of a business which uses components manufactured by a supplier. Should a fire occur at the supplier's premises the business of the insured would suffer a revenue loss. So the business interruption policy could have a suppliers extension covering the event of a fire at the suppliers premises. Extensions are usually options for additional cover not offered as part of the central cover. Extensions are usually optional and are added to the central cover at an additional premium. Not every identifiable event is covered by the operative clause, but these can be covered under the extensions (Glynn, Taylor & Nock, 2020; Vivian & Mushai, 2020). Losses sustained as a result of pandemic and/or infectious disease outbreaks, are usually covered under extensions

with specifically worded policies. Extensions with specifically worded clauses, relate to events which give rise to specific claims and losses covered by that extension. Currently there are approximately thirty different type of extensions to the main policy. The following are examples of types of extensions which are added to the policy to cover business interruption losses:

• Denial of access: customers unable to visit the insured because of damage nearby;

• Loss of an attraction that encourages customers to frequent the business;

• Failure of power supplies or telecommunications to the insured premises;

• Damage at suppliers' or customers' premises ; and

• Notifiable disease.

Generally insurers provide cover and accept risk under specific terms, having assessed the risk exposure and determining the premium payable for that risk. Disclosures are made by the insured under specific terms and conditions of the policy. Insurers do not under general or central cover, provide cover for risks which have not been assessed. Precise policy wording is the basis upon which insurers assess and manage their exposure to insured risks.

Business interruption or business income clauses are usually included in property polices. Some are covered within the policies and others as extensions. Business interruption usually covers insureds for losses of business income arising directly as a result of physical loss, damage or destruction of property, by as covered peril.

There are a variety of different clauses in use, which will be considered further in the study. A usual clause may be as follows:

> 'We will pay for the actual loss of business income you sustain due to the necessary suspension of your "operations" during the period of "restoration." The suspension must be caused by the direct physical loss, damage, or destruction to insured property. The loss or damage must be caused by or result from a covered cause of loss' (Marsh, 2020).

The wording used to express the central cover of policies and extensions vary, there is a consistent use of much of the same language as will be discussed. In order to ascertain whether the policies and extensions will respond to the claims for business interruption certain

important concepts will be considered. The following are examples of various extensions which became the subject of scrutiny and were relevant to the Covid-19 business interruption cases:

Denial of access clauses

The denial of access extensions are included in policies to provide cover for damage to property in the radius of the insured premises, impacting on the operations of the business and non-damage restrictions e.g. national lockdowns or local action by government (Glynn, Taylor & Nock, 2020).

- **Denial of Access as a result of damage**

  This provides cover in instances where there is damage to the property of others in the vicinity of the insured premises, which impacts on the business. The denial of access may not be absolute but may amount to a prevention, hinderance or interference of the business. This cover could also cover the loss of the use and occupancy of the premises due to the damage. It is important to note, that for this extension to be triggered, physical damage is still required in the vicinity which impacts on access. Wordings of these clause vary and some are wider than others and those may respond to incidents in the vicinity or within a specified radius from the insured premises, causing damage (Glynn, Taylor & Nock, 2020).

- **Non-damage Denial of Access**

  Non-damage denial of access provides cover for instances where there is no physical damage, but due to an order of a local authority or national government, access is denied to the premises. As pointed out by Glynn et al (2020), these extensions only respond if there is a complete denial of access not merely a hinderance. In addition, commonly the wordings the national or local instructions should arise from an incident in the defined radius rather than at the premises itself e.g. rioting or bomb scares within the radius of the premises.

Loss of Attraction

The cover that this extension provides is in instances where a neighbouring property close to the insured premises, which draws customers for the insured business, is damaged. The impact of the damage to the property which is a ‘drawcard’ for the insured business is that no customers then visit the business. The wording of this extension typically refers to damage to physical premises (Glynn et al, 2020).

Notifiable Disease Clauses

This cover is a common extension in policies for hotels and restaurants. As became evident during the Covid-19 pandemic, the entertainment and hospitality industries globally suffered significant losses as they had to close down and comply with national and local government orders. It will be noted in the clauses that were considered during the court cases, that these clauses include cover for suicide, murder, attempted murder and some are broad enough and include crime and incident investigations (Glynn et al, 2020). The important features for cover are: the murder, suicide, disease must occur within the defined radius or at the insured premises; the notifiable disease, in addition to having occurred at the premises or within the radius, it must be a contagious or infectious disease to humans listed as such in a list of diseases or must be legally notifiable.

There are other extensions which offer specialist cover for business interruption e.g. cyber or machinery business interruption, which will not be discussed in this dissertation as they are not relevant to the current analysis.

5.3 Exclusions to the BI Policy

Exclusions are clauses used by insurers to limit, qualify, or define the transferred risk. In the ordinary course, they identify what is not included in the cover. They are usually included in a separate section of the policy and are grouped together. Exclusions on a policy indicate that in the event of certain perils occurring, the risk will not be covered by the policy. Exclusions narrow down the scope of cover of a policy. The primary function of having exclusions in a policy is to enable individual and small business to hedge against the risk of financial loss, and protecting insurers business interests. These policy provisions waive coverage for defined perils- being risks that they are unwilling to cover for various reasons. Insurers are protected by exclusions, as they are exempted from covering certain events.

Business interruption insurance as is proposed, is uninsurable. The reasons will be analysed fully below. Generally these type of risks which place a financial burden on the financial stability of an insurer, will in the ordinary course be excluded from cover, especially as there is simultaneous negative impact on a large number of policyholders. The principle of the 'Law of Large Numbers' will not operate in these instances. 'The classic reason for using an exclusion is to control and mitigate a specific risk present in the insured pool' (Hannover Re, 2010).

The general approach of the South African courts is to apply a strict interpretation to penalty, limitation or exclusion clauses. As stated in *Guardrisk Insurance Co Ltd v Café*

Chameleon CC (2021) the rationale for this approach it that contracts of insurance are indemnity contracts and should be interpreted reasonably and fairly. It is the duty of the insurer to clearly explain specific risks which it excludes (*Centriq Insurance Company Limited v Oosthuizen and Another* (2019)), and if there is any inconsistencies or ambiguities, then the *contra proferentem* rule is applied. This principle is usually followed in conjunction with the interpretation of exclusions, which are strictly interpreted.

5.4 Trends Clause

The trends clause came under much scrutiny in the Covid-19 litigation. The purpose of this clause is to adjust the loss an insured suffers as a result of the insured peril, to ensure that the insured is put in the same trading position after the business interruption, as if the peril had not occurred. In the case of the *Orient Express Hotel*, the trends clause was considered in depth and has been discussed in the analysis of the case in Annexure C, where focus was placed on the trends clause in the policy. In instances where there is a notifiable disease extension, which does not involve damage to property, the trends clause cannot be applied. The trends clause is only applicable in instances where the business interruption results as a consequence of physical damage to property.

It is submitted that in the Covid-19 litigation, where there clearly was no physical loss or damage, the trends clause was actually irrelevant. This is a further reason which the overturning of the *Orient Express Hotels* case was distinguishable from the Covid-19 cases and that the decision was correct.

5.5 Conclusion

In the litigation which arose as a result of business interruption due to Covid-19, the UK and South African courts focused mainly on the law of insurance, specifically applying the post 1918 notion of proximate cause, and on the wording of the extensions of the policies. The courts paid little attention to placing the extension in the context of the main policy. The courts and the regulators followed the route which favoured the insureds relying to an extent on the principles of fairness. The FSCA released numerous press releases, where it stated that he national lockdown could not be used as a ground to repudiate valid business interruption claims. It furthermore, encouraged insurers to consider principles of fairness and justice when assessing claims arising out of Covid-19. As will be discussed below in the next chapter, in the case of *Guardrisk Insurance Co Ltd v Café Chameleon CC* (2021), the SCA stated that an insurance contract is a ‘contract of indemnity’ and should therefore be interpreted ‘reasonably

and fairly'. The statement of Judge Oliver Schreiner, who did not resort to concepts such as fairness, was referred to by the SCA: 'in all cases, it must be liberally construed in favour of the insured, so as not to defeat without a plain necessity his claim to indemnity'.

6 JUDICIAL INTERPRETATION OF THE POLICY

As indicated above this policy has not often been considered by the courts and thus the body of knowledge lacks the benefit of the insight it could have got from judicial interpretation. It is thus worth discussing the few cases which did come before the court. The first line of defence when individuals and companies suffer loss, is to turn to their insurance policies for compensation for loss suffered. Covid-19 pandemic has highlighted challenges faced by insureds when claiming in these circumstances. When the pandemic was declared in early 2020, many affected businesses, which submitted claims, ascertained that their existing property policies did not cover for the pandemic through the main business interruption insurance policy. This is the message which was given world-wide to insureds. The matter is different where policies contained specific extension which appear to cover the event.

Claims for business interruption for the Covid-19 pandemic were submitted globally. Claims by policyholders relating to business interruption losses due to Covid-19, involved two types of policies. Firstly there is the standard business interruption insurance policy, which covers damages sustained to underlying physical damage, and the resultant loss of revenue. In South Africa, most of the policies relating to business interruption are these types of policies. Early in the pandemic insurers indicated they would not admit Covid claims as business interruption claims. The if claims were submitted insurers repudiated these claims on the basis that Covid-19 does not cause physical damage to property and thus there is no insurable revenue loss. The loss was caused by the closure of business and loss of business was due to the government lockdown. On this basis, claims of this nature would be repudiated.

The second type of business interruption policy, is one where the policy contains an extension for inter alia infectious or contagious diseases, within the insured business or in its area of operation or at another premises within a defined radius. The closure of the business in this case resulting in loss of revenue was the subject of litigation. The courts concluded the loss was covered under such a policy. The challenges raised with the interpretation of various policy wordings and the cases which deal with these losses, are analysed below and in greater detail in the annexures. The second type of policy was extensively used in the hospitality industry.

In the UK, the regulator, the FCA launched a court action to seek clarity on the various policy wordings in terms of specific legislation designed to cover this eventuality. In South Africa the matter was approached as is usually the case via test cases. Initially the South

African regulator favoured adopting the UK approach and it would approach the courts for clarity, but that approach was not followed mainly because the UK decision would in any event be used as guidance in South Africa. Thus in SA various matters were taken to court challenging insurers which had repudiated claims for losses sustained because of the Covid-19 lockdown. It should be pointed out that at the early stage repudiations were considered by the Ombudsman who, correctly it is submitted, accepted this matter would best be resolved via the courts.

Seventeen types of policy wordings were identified by the FCA, to illustrate the key issues in dispute. The main purpose of these court proceedings, was to ascertain whether the business policies, containing specific extensions, cover losses sustained due to the pandemic and governmental lockdowns (Gurses, 2021). These cases are discussed in detail in Annexures "A" to "G" which are attached. A general discussion of the important points of the cases are now discussed.

6.1 UK Cases

6.1.1 Early Cases

The courts made it clear that property damage policies did not cover consequential losses or legal liability claims and shortly after the introduction of the BI policy in the late 1800s the courts heard some cases involving the BI policy. Two (of at least three) early cases are discussed: It should be noted these cases were heard before the BI policy was formally adopted by the UK Tariff Committee in the late 1930's.

City Tailors v Evans [1921] 91 LJKB 379 (CA) 6.

Henry Booth &Sons v Commercial Union Insurance Co Ltd [1923]14 L1 L Rep 114.

A more detailed analysis of the facts and decisions of these cases are annexed hereto as Annexure "A".

The insurer in the *City Taylors* case was a Lloyd's syndicate represented by Evans. The policy provided cover on a *per diem* basis, a fixed amount of money became payable for each day that the small clothing factory was out of operation. A usual term was included in the policy, which was a common law requirement for the insured to take steps to mitigate against the loss. When the insured event occurred, a fire, the insured moved the operations to nearby premises and stared operations from those premises. It took 12 months to rebuild the damaged factory. Notwithstanding that the insured recommenced the business from the alternative

premises, the insured claimed the *per diem* for the entire period of 12 months. As the clause requiring the insured to mitigate losses was included in the policy, the insurer anticipated that it would only be liable for the period during which production had ceased plus the increased cost of working. The decision of the court, however, was that the insured was entitled to cover for the entire period. This was not a decision which the market had anticipated. To address this issue thereafter, a memo was inserted into the policy which a 100 years later is still included:

> **'Memo**
> If, during the indemnity period, goods shall be sold or services shall be rendered elsewhere than at the premises for the benefit of the business either by the insured or by others on their behalf, the money paid or payable in respect of such sales or services shall be brought into account in arriving at the turnover, revenue or gross rentals during the indemnity period'.

'In any event the standard policy adopted after 1932 was vastly different to the *per diem* policy applicable in the *City Taylor* case. But for our purpose, it is important to note the market and judicial view are different. These may not coincide. The market remedy is then to amend the policy wording' (Vivian, Spentzouris & Taylor, 2022).

It is evident from the *City Taylors v Evans* (1921) decision, that an insured was not obliged to start operations at a new site in response to the duty to mitigate loss. The policy was structured in a way that it was a valued policy. A valued policy is one where the parties agreed on the value that will be paid in the event of a future loss. It agrees to the extent of the indemnity. This assists the insured in the event of a loss, as the insured would not be required to prove its actual loss.

However, an insured's claim for indemnity may not coincide with the figure arrived at through the application of the theory of indemnity. Under the wording of updated business policies, this would not have been the decision of the court as in the ordinary course, the increased cost of working clause would cover this loss.

The court in the case of *Henry Booth & Sons v The Commercial Union C ltd* (1923), although it pointed out that the consequential loss policy is a valued policies which common practice in marine policies, the policy provided defined basis of indemnification for the loss sustained. The principle of indemnification is fundamental in these policies accordingly compensation should be only to compensate the actual loss suffered. The valued policy, where an agreed indemnity value is set out, may challenge the general principle of indemnification, as an agreed value can be more or less than the loss suffered by the insured.

The importance of these two earlier is that the courts made it clear the consequential policy was a valued policy and would not venture down the path of the court determining the basis of indemnification from general principles as part of the litigation. It was up to the insurers to set out how the quantum must be determined.

6.1.2 UK Covid-19 litigation

The UK regulator, the FCA , launched legal action to seek clarity on the issue of the wordings of policies covering business interruption claims arising from Covid. Seventeen types of policy wordings were identified by the FCA, which illustrate the key issues in dispute. The main purpose of these court proceedings, was to ascertain whether the business policies cover loss sustained due to the pandemic and governmental response of imposing lockdowns (*The Financial Conduct Authority v Arch and others* , 2021). A more detailed analysis of the facts, arguments, decisions and discussions of both the High Court and the Supreme Court cases are included at an annexure as Annexure "B".

The matter was initially heard in the High Court and subsequently was taken on appeal directly to the Supreme Court. As it was said, it leapfrogged over the Court of Appeal directly to the Supreme Court – one of the very many unusual features of this litigation. The important key points to note from the SC case, are the following:

(a) The appeal by the insurers was largely dismissed, and the SC held that notifiable disease extensions and hybrid extensions responded to the effects of the Covid-19 pandemic. It is notable that the 'but for' test which was relied upon by the High Court, in dealing with the trends term in the policy was not approved by the SC who followed different reasoning and in so doing expanded the scope of the principle of proximate cause (Herbert, Smith & Freehills, 2021).
(b) In respect of the appeal by the FCA under the prevention of access extensions and hybrid extensions, certain arguments by the FCA were permitted. In particular that partial closure was sufficient to trigger these clauses.
(c) The leading decision on trends clauses, the *Orient Express Hotels* case was challenged and overturned by both the High Court and the Supreme Court. It held that trends clauses generally have no application to the effects of Covid-19. (A case study of the *Orient Express Hotels* case is annexed as Annexure "C".)

An important point to be noted from the Supreme Court case, is that the court concluded that the approach of the court in the *Orient Express Hotels* case is incorrect. Once understood the fundamental issue of the *Orient Express Hotels* is simple enough. A hotel in New Orleans was damaged by hurricane Katrina and was shut down for the month of September. At the same time New Orleans was shut down because of the hurricane. The insurer argued even if the hotel had not been damaged it would not have earned any income because of the shutdown. This produced a dispute between the insured and insurer which was sent to arbitration. The arbitration panel agreed with the insurer which decision was confirmed by the High Court. It is this issue which was reconsidered in the Covid-19 litigation and was overturned. The implications of this for business interruption cover in natural disaster and other physical damage cases, is clear, particularly with regard to the interpretation of the trends clauses (Gurses, 2021). Parties should review these clauses particularly with this decision in mind (Herbert, Smith & Freehills, 2021). The 'but for' test has been determined that in certain circumstances, it will not be applicable in addressing questions relating to the proximate cause. In instances where its application would result in the narrowing of cover, or removal thereof, the rational is that this could not have been the intention of the parties, and accordingly, would not be applied (Herbert, Smith & Freehills, 2021; Gurses, 2021). The court concluded that Covid-19 and the lockdown should be treated as a composite peril. As pointed out (Herbert, Smith & Freehills, 2021), that:

> 'certain elements of a composite insured peril should not diminish the scope of the indemnity due to an insured if they arise from the same original fortuity which the parties to the insurance would expect to occur concurrently with the insured peril'.

Uninsured perils should also not affect the scope of cover, where they arise from the same event from which the insured peril arose. The court emphasised that the wording of the policy must be focused on and the construction of the policy must provide guidance on how to interpret and determine the indemnity which the policy provides (Gurses, 2021). The implications of this case are wide and impact the insurance industry generally, particularly in respect of trends clauses and causation. The effectiveness of exclusion clauses will in future have to be closely analysed (Gurses, 2021).

In the case summary attached as Annexure "D", a summary is presented of the case of *TKC London Limited V Alliance Insurance PLC*, which was another case which was considered as a result of the Covid-19 lockdown. Unlike the FCA test case, the court in this case was not required to consider any disease or denial of access clauses. It was the first case in the UK where the court dismissed the case due to a lack of evidence of "physical loss" to property.

This requirement has been emphasised by the US courts, and a failure to suffer physical damage, results in decisions by the court to dismiss this matters.

6.2 South African Cases

6.2.1 Earlier Cases

Before the Covid litigation, on only three occasions have the South African courts considered the business interruption policy in reported cases. These cases however did not involve the interpretation or construction of the policy. Nevertheless for sake of completeness these cases are analysed in Annexure "E" attached hereto. The two cases discussed in Annexure "E" are:

Govender v Mutual and Federal Insurance Company 2005 CLR 257 (D)

Mutual and Federal Insurance Co Ltd v Chemalum (Pty) Ltd 2007 (2) SA 479 (SCA)

The third business interruption case which has been considered by the South African courts is the case of *PFC Food CC v Three Peaks Management (Pty) Ltd* (5573/2009) [2012] ZAKZDHC 57 (10 September 2012). The case dealt with the legal duties of a broker- the defendant- towards the insured- the plaintiff. The claim arose from an insurance contract which had been placed for business interruption cover with Zurich Insurance Company South Africa Limited. The insured alleged that the broker had breached its obligations as per the mandate as when a claim arose for the insured event, the claim was not paid in full on the basis that the plaintiff was under-insured. The focus of this case was on the duties of the intermediary and there was no in depth discussion of the business interruption policy.

The Multimark III Policy, which was the policy subject to the litigation in the *Govender v Mutual and Federal Insurance Company* (2005), is a policy document containing numerous types of cover provided by various sections (Vivian, 2005). It was the industry standard policy. Depending on the type of cover required, the insured would select the appropriate sections. As pointed out by Vivian (2005), in these complex documents the sections do not 'always dovetail seamlessly'. It is also not unknown that a court in interpreting a particular section within the policy document has used sections not selected by the insured to arrive at a decision. In this case the fit is even more problematic, and the document does not necessary fit together. 'This is tantamount to the court using a contract that is not before it to reach a conclusion about a contract that is!' (Vivian, 2005).

In the Govender case the fire property damage cover was provided by the fire section while the business interruption was provided in terms of the business interruption section. Each section had its own schedule. The fire section listed properties covered by the fire section and

the business interruption contained a different list. A fire broke out at a property not referred to in the business interruption section but referred to in the fire section. To make matters worse the business interruption section, although having its own schedule did not refer the existence of any schedule The question then arose was the damaged property was in fact covered by the business interruption section.

The following point was made by Vivian (2005), accepting the decision of the court as being correct:

- Cover that is provided in terms of the business interruption section of the policy, is in fact being provided for all the premises listed under the fire section, which inevitably increases insurers to increased exposure; The insurer thus ended up covering properties it is not clear the insurer intended to cover.
- He suggested that the operative clause should be revisited to ensure clarity of which insured premises are covered in respect of each section; and
- The sections of the Multimark III Policy which are not selected as part of the policy, should be removed to avoid creating unnecessary confusion.

It is apparent from *Mutual and Federal Insurance Co Ltd v Chemalum (Pty) Ltd* (2007) which involved business interruption, specifically the interpretation of the trends clause. It is this clause which featured in the UK Covid-19 litigation. As indicated the business interruption policy is a valued policy and thus needs to set out clearly how the indemnity value is calculated. In a normal indemnity type of policy, the if the insured value is less than the indemnity value, underinsurance exists, and the insurer would apply average to settle the claim. In a valued policy since the measure of indemnity is pre-determined the question of the application of average can arise. The BI policy states how the question of average is to be dealt with. The *Chemalum* case involved the question of average as applied to the BI policy. The focus of the argument presented by the parties, was on the contract wording which defined standard income, average and so on. These requirements translated into calculations of the damages for business interruption loss. When a loss occurs the insured needs to determine the standard income, the income which would have been generated had the loss not occurred. This can be compared to the annual income. The two figures should be the same and if the standard income is less than the insured is underinsured. Because of the complexity of the wording the High Court concluded no adjustment for average was necessary. The decision of the Supreme Court of Appeal was correct and ruled that adjustments had to be made in accordance with the provisions of the average clause, resulted in the insured being underinsured at the rate of 58%. The

insurer's liability was reduced substantially. Insured's may be penny-wise but ultimately, may be pound foolish, by saving on premiums but when a claim arises, they bear the brunt of the proportional reduction in terms of the 'average clause'.

This case is thus important to assist in understanding the concept of average in the BI policy and hence in valued policies in general. The general principle of valued policies clearly applies; average needs to be dealt with in the policy itself.

The third case involved a "professional" liability case against an insurance broker. As indicated the BI policy is regarded as the most complex polices not fully understood by most of the industry. The application of the policy involves understanding of accounting records. As indicated above the basis of the insurance is making a distinction between variable costs, standing, costs, profit and turnover. Few brokers are able to recast the insured's financial statement so as to arrive at the correct figure. In the case under consideration the broker did not attempt to do so but arranged for the insurer to meet with the insured. In the end a loss occurred and it was established the insured was underinsured and the broker was sued for the loss the insured suffered. The insured succeeded in the claim.

An insurer developed a BI calculator to assist in the calculation of the sum insured.

6.2.2 SA Covid-19 litigation

In South Africa, various matters were litigated in court in which insureds challenged insurers which repudiated claims for losses sustained because of the Covid-19 lockdown. These cases involved policies which contained the contagious (and similar clauses) with the insureds coming largely from the hospitality industry. The South African cases of *Café Chameleon CC v Guardrisk Insurance Company ltd* (2020), *Ma-Afrika Hotels (Pty)Ltd v Santam Limited (2020), Interfax (Pty) Ltd v Old Mutual Insure Limited* (2020) and *Guardrisk Insurance Company Ltd (2021)* have emphasised the importance of businesses taking note of the contents and wording of the main policies, extensions and exclusions, in order to ensuring that losses are covered as understood and planned. Two of the cases were taken on appeal which confirmed the high court's decisions. Confirmation must be made by insureds that losses can be covered and that an interpretation favouring indemnification can be applied. The recent South African cases involving the topic of this research, are discussed in greater detail in Annexure "F" attached.

In the *Café Chameleon CC v Guardrisk Insurance Company ltd* (2020), the insurer started with their fundamental argument the cover was against the disease and not the subsequent action of the government of imposing a lockdown. Closely allied to this argument

was that the cost of the lockdown was prohibitive and could not be covered by the insurance market. The court rejected both of these arguments. With respect to the first the court accepted a composite peril – virus-lockdown. With respect to the second the court firstly rejected the view of insurers as speculation since no evidence had been put before the court and secondly the court pointed out the insurer would be bound by its promise. Insurers had expected their argument to prevail and left other arguments for the appeal, and other cases. On appeal the court agreed with the high court regarding causation but insurers had raised additional arguments in this case the application of the trends clause, the court considered the application of the trends clause. In this case, the insurers attempted to reply on the position set out in the *Orient- Express case* (2010), As indicated above this case confirmed if an insured would not have suffered a loss but for the damage to the insured property the insured is not entitled to indemnification. While the SA litigation was underway the UK courts; the High Court and Supreme Court, were overturning the earlier Orient Express decision. As pointed out above it is because the UK courts would deal with the same issues, the SA market view was SA should wait for the UK decision before embarking on litigation in SA. In any event the SA courts came to the same conclusion concerning the Orient Express case; that it should not be followed. By the time the Café Chameleon case reached the SCA the UK courts had delivered their judgement. The court was also persuaded based on the analysis of the court in the *Orient-Express* case, to follow a similar approach with regard to the interpretation of the trends clause. SA insurers argued for a narrow interpretation of the insured peril; that is not for the composite Covid-19-Lockdown peril argument. In the end the SA courts came to the same conclusion as the UK court's ruling which found in favour of insureds.

The SA courts were faced with many questions concerning cover in respect of Covid-19 related losses, exposures and liabilities. The coverage issues and potential arguments, both for and against cover for Covid-19 related losses will be extensively considered. These will be considered in light of the numerous policy wordings in the SA market. To determine whether there is cover, involves the interpretation of the insurance policy in dispute. Legally, the interpretation of the insurance policy of contract, is understood in SA law as a unitary and objective legal exercise. Throughout the process, considerations of wording used in the policy are accounted for, as is the context and application of the contract (Wallis, 2019).

Cover for BI is found in Assets All Risks or Commercial Policies (the Multimark III Policy) generally. The BI extension of the policy is usually triggered by physical damage to

the insured property. In certain instances, where extensions to the policy are concerned, it may be triggered by damage to third party property.

The problem comes when the policies in the hospitality industry are examined. These are not standard policies and contain extensions unrelated to physical damage. An example of this is if an contagious and infectious disease occurrence is covered under a Contagious and Infectious Disease extension. The SA courts considered BI extensions, which were relied on by insureds, particularly the Contagious Disease extension, which do not require physical damage. Non-physical damage is contrary to the historical reasons for the BI policy and the extensions to these policies.

An example of such a clause in the hospitality policy is:

> 'Loss following interruption of or interference with the Business in consequence of contagious or infectious diseases within a 50km radius of the Premises'.

Numerous insurers took the stance that these policies did not respond to Covid-19 claims or an attempt to limit the cover within the bounds of a narrow interpretation of these extensions. The extension provides cover following "interruption … with the business in consequence of … contagious diseases …" The interruption was caused by the lockdown and not the disease. But so the argument goes the contagious disease (Covid-19) caused the lockdown. The one caused the other. Insurers argued the proximate cause was Covid-19. The UK insurers resolved this issue by recognising a composite proximate cause Covid-19-Lockdown. The responses of numerous insurers are assessed and discussed in Annexure "F", a few examples of these responses are as follows:

- 'It was never the intention of the extension to provide cover for a pandemic event affecting the whole of South Africa" but rather it was only "meant to provide protection against a local outbreak of infection' (*Café Chameleon CC v Guardrisk Insurance Company Ltd,* 2020).
- The 'lockdown is a separate event from the contagious disease', which intervenes and substitutes the disease as the true and proximate cause of the business interruption loss, whereas such loss must be 'caused by the presence of the disease itself, distinct from the impact of the lockdown' (*Café Chameleon CC v Guardrisk Insurance Company Ltd,* 2020).
- The 'radius requirement' requires medical proof of persons infected with 'COVID-19 within the radius', in order to demonstrate that such infected persons proximately

caused the business interruption loss (*Café Chameleon CC v Guardrisk Insurance Company Ltd,* 2020).

- Cover is only provided for business interruption loss resulting directly and solely as a result of the presence of COVID-19 discovered at the insured's premises, which is reported via the required governmental channels, and requires the policyholder to shut down its operations in order to sanitise the premises, and only for the duration of such required shut down to eradicate the outbreak of COVID-19 at the insured's premises.
- The occurrence of a contagious or infectious disease within the required radius of the insured's premises or at the insured's premises must be shown to be the sole and direct cause, to the exclusion of all other causes, of the business interruption loss.

Other extension relating to the denial of access and acts of authorities extensions were also relevant to claim for BI losses resulting from the national lockdown. Usually these once again require the prevention of access or use, preceded by physical loss or damage to the insured premises, or a defined insured event under the policy. These limitations may serve as exclusions for losses resulting from the lockdown, which occurred absent of physical damage to the insured property. Examples of the wordings of these clauses which will be considered are as follows:

- Denial of Access:

  'Loss resulting from interruption of or interference with the business in consequence of Damage to property by an Insured Peril within a 20km radius of the Insured's premises, destruction of or damage to which shall prevent or hinder the use of the premises or access thereto, whether the premises or property of the Insured therein shall be damaged or not'.

- Acts of Authorities:

  'The Insurer shall indemnify the Insured in respect of any period of restriction of access to or use of any part of the Premises by action of a civil, public or other regulatory body following a Defined Event, provided that any action of a civil, public or other regulatory body which restricts or denies access follows Damage to Insured Property'.

A particular issue which was hotly contended in the *Ma-Afrika Hotels (Pty)Ltd v Santam Limited* (2020) case, is Santam's interpretation of the policy which limited cover to three months only. As has repeatedly been pointed out in the SA cases involved extensions to the policy, there are approximately 30 extensions. In the schedule of extensions appears a term indicating the cover provided by the extensions is for a period of 3 months. In addition

many of the 30 extensions have their own indemnity periods. The contagious disease extension did not have its own extension. The question then arose did the policy identity period or the general indemnity period of the extension apply. . The Western Cape High court pointed out are paragraph 86-87 that:

> 'The applicants have established that they have an existing contractual right to indemnity under the infectious diseases clause to the policies, and to an indemnity period of eighteen (18) months, ……..It is evident that the infectious disease clause is not one of the twenty-six items listed under the "Extensions and Clauses" heading in the schedule. Some of these items, like "Loss of Tourist Attraction" and "Loss of Aesthetic Attraction" expressly record an indemnity period of three months. Others do not, like the "Bush Fire" extension. It appears that the residual three-month period may be applicable to these listed extensions. It could be reasonably concluded that the residual indemnity period does not apply to the infectious disease clause because it is not a listed extension. Instead, it comes as a standard feature of the business interruption section'.

In the circumstances, the High Court found in favour of the applicant and ruled that the *contra proferentum* principle should be invoked stating that: 'If Santam wanted to limit the indemnity period for infectious diseases to three months in this contract that it drafted, it could simply have added the clause to the long list of specific extensions'. The decision of the High Court was confirmed on appeal by the SCA. The court registrar wrote in the summary of the SCA decision:

> 'In the court's view, the indemnity period in relation to claims for loss of revenue due to business interruption, ineluctably, was 18 months. In any event, given that the policies were admittedly difficult to navigate, and assuming, at best for Santam, that there was a meaningful degree of uncertainty concerning the indemnity periods, a conclusion might be reached that on that aspect the policies were ambiguous'.

The SA courts embarked on a complex interpretative process when considering the business interruption policies during Covid-19, and were subjected to various arguments both for and against cover for BI losses due to the pandemic.

By focusing on interpretation of the policies, it will be considered further below, whether the contentions made by the insurers were in fact too simplistic, in consideration of the legal process of the interpretation of insurance policies. Legal interpretation of contracts requires contextual and commercial construction. The following rules of interpretation relevant to insurance policies were considered :

- Interpretation of an insurance policy does not take into account the subjective intention of the contracting parties, and equally does not consider subsequently what a party might subsequently contend the policy was intended to cover.
- Words usually used in these clauses such as 'in consequence of' or 'due to' must be considered and applied in order to determine whether or not Covid-19 is the proximate cause of the loss, or whether the government lockdown of the premises caused the loss.
- Words also included in these clauses such as 'within a radius of' must be interpreted commercially and within the context of the global pandemic.

6.3 Changing basis of legal Interpretation

In recent years the courts have been moving to a novel basis of interpreting contracts, the so called business-like basis, which have been applied to insurance contacts. For sake of completeness this new basis is discussed.

6.3.1 Introduction

The case of *Centriq Insurance Company Limited and Oosthuizen* (237/2018) [2019] ZASCA 11; 2019 (3) SA 387 (SCA) sets out the general principles of interpretation of insurance policies and other contracts, as follows:

- Insurance policies are classified and dealt with like any other contract.
- Provisions of contracts must be construed considering their language, context and purpose in conjunction with one another.
- The meaning to be preferred is a business-like and commercially sensible meaning.
- An objective approach to interpretation must be followed. The purpose is to determine the intention of the parties, considering the words used in the context of the entire document and the circumstances and facts in which the contract was concluded.
- Provisions which are restrictive on the insurer's obligation to indemnify, must be interpreted restrictively.
- The language, context and purpose of all clauses, including exclusion and extension clauses, must be considered in light of reaching a commercially sensible result.
- A fair and sensible application must be followed when interpreting literal meaning of the words in a contract, in the event that the literal meaning produces an unrealistic and unanticipated result which is contradictory to the objective of the policy.

- In the event that the policy appears to 'drive a hard bargain', courts cannot lean towards an interpretation which is more favourable to an insured, than the language properly interpreted allows.
- It is not for the courts to construe exclusions in favour of the insured simply because it considers them to be unfair or unreasonable (Dinnie, 2020).

In the event that the enforcement of the contractual terms of a contract, are, from a subjective perspective, unfair, unreasonable or unduly harsh, no court is permitted to refuse to enforce the terms as such. Where a contractual term or its enforcement is so unfair, unreasonable or unjust, that it is contrary to public policy, a court id only permitted them to refuse to enforce it. Constitutional values determine public policy considerations. Decisions about the interpretation of contractual conditions are not determined by abstract considerations of good faith, reasonableness or fairness. These principles form the basis of legal rules, which in turn determine the parameters of interpretation.

In the case of *Barkhuizen v Napier* ((CCT72/05),[2007] ZACC5; 2007(5) SA 323 (CC); 2007(7) BCLR 691 (CC) (4 April 2007)), the Constitutional Court held that 'while public policy imports notions of fairness, justice and reasonableness into our law, parties are generally required to honour contractual obligations that they have freely and voluntarily undertaken.' *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* ((CCT109/19) [2020] ZACC 13; 2020 (5) SA 247 (CC); 2020 (9) BCLR 1098 (CC) (17 June 2020) confirmed the approach in *Barkhuizen*. A clause will be assessed as to whether it is unreasonable, and will consider whether it is contrary to public policy to enforce it, whether it is reasonable or unreasonable. The party challenging the enforcement of the clause as being unfair and unreasonable, bears the onus to prove it. Public policy should be applied with restraint. Constitutional values should be infused into public policy if the facts require it (Dinnie, 2020).

6.3.2 Challenges of interpretation

The process of interpretation takes place after the completion of a contract. 'It is overwhelmingly undertaken in relation to a written record of those prior actions and involves attributing meaning to a written text'. The process does not concern itself with the conduct prior to the formation of a contract (Wallis, 2019).

There is a plethora of legal rules which provide parameters for the interpretation of legal documents. These legal rules are a combination of conventions, maxims, principles and authorities which give rise to a group of complex dilemmas. These appear in the use of plain

language, the use of definitions, the tension between a need for consistency and the requirement that law evolve in step with social change (Hutton, 2009).

The process to interpret contracts requires that an objective approach to interpretation is followed. Where the plain meaning of the words is clear, then that interpretation must be given to the wording. In the case of *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2010] ZASCA 13 ; 2012 (4) SA 593 (SCA), it was stated that Courts should not 'make a contract for the parties other than the one they in fact made'. In both South Africa and the UK, there has been a 'gradual shift away from a literal process of interpreting contracts and statutes to one where both text and context have a role to play' (Wallis, 2019).

It is generally accepted that language and syntax, and sometimes context, will predominate. *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2010 & 2012) challenges the previously accepted proposition that interpretation is an exercise that occurs in phases. The text is the starting point which must be viewed in the context in which it was written (Wallis, 2019).

> 'Then context will come into play to a greater or lesser extent. The clearer the language used in the text and the more obvious its meaning in accordance with the ordinary understanding of language, the less the influence of context in arriving at a conclusion as to its meaning. The more possible meanings there are and the more finely balanced they are, the more powerful will be the influence of contextual factors in the ultimate decision. In construing legislation or developing the common law the influence of the spirit, purport and objects of the Bill of Rights is an essential part of the context. But there is a line to be drawn beyond which the interpreter cannot go. Context cannot be used to create a meaning that the language, when viewed in context, is incapable of bearing. That is not interpretation. It is contractual or legislative drafting (Wallis, 2019).

The process of interpretation is an objective one. The general understanding of this is that the language used in the document will be focused on in order to determine the meaning of the document. The unwritten unexpressed intention behind the document should not be considered when referring to objective interpretation. The court's purpose is to construe the text used in the document and not to add unexpressed meanings to the text. As 'contracts of indemnity' insurance policies should be interpreted 'reasonably and fairly to this end'(*Norwich Union Fire Insurance Society ltd* at page 222*).*

Insurance policies are standard form contracts, generally referred to as 'contracts of adhesion' (*Barkhuizen v Napier* at paras 135-139 and 151-157), as no negotiation takes and policyholders are required to sign it on a take it or leave it basis. As pointed out by Wallis (2019), as little or no negotiation takes place before, no purpose is achieved by considering the context in which the contract was signed. In the consideration of these contracts, the role of the external facts play little or no role, so with insurance policies, this process is not really

applicable (Wallis, 2019). However, when there is unequal bargaining power, cognisance must be taken of this fact. So fairness and equity must play a role and must be considered as part of the context.

The approach to the interpretation of contracts, was dealt with in *Natal Joint Municipal Pension Fund v Endumeni Municipality.* It was followed in the cases of *Bothma-Batho Transport (Edms) Bpk v S Bothma & Seun Transport (Edms) Bpk* and *City of Tshwane Metropolitan v Blair Atholl Homeowners Association.* The court indicated that the approach to follow, was to move away from a 'narrow peering at words' and that words must not be considered in isolation. The distinction between context and background circumstances is no longer acceptable. 'Words have to be interpreted sensibly and not have an un-business-like result.' The approach has to be holistic and unitary considering all contextual and background factors.

The court in *Centriq Insurance Company Limited and Oosthuizen* (2019) cited the following statement by Schreiner JA, which was further referred to by the SCA in the *Guardrisk Insurance Company Ltd v Café Chameleon CC:*

> 'No rule, in the interpretation of a policy, is more firmly established, or more important and controlling, than that, in all cases, it must be liberally construed in favour of the insured, so as not to defeat without a plain necessity his claim to the indemnity, which in making the insurance, it was his object to secure. When the words are, without violence, susceptible of two interpretations, that which will sustain the claim and cover the loss, must in preference be adopted.'

However, in the case of *Ma-Afrika Hotels and Another v Santam Limited* [2010] ZASCA 13 ; 2012 (4) SA 593 (SCA) the court at paragraph 74, made the following statement:

> 'Insurance is intended to serve as a social safety net to cover financially devastating losses and compensate injured parties. This is precisely the safety net required as a result of the unprecedented Covid-19 pandemic'.

As pointed out in *Guardrisk Insurance Company Limited v Café Chameleon CC* by Cachalia, JA, this approach is not aligned to the approach of South African law.

In *Guardrisk Insurance Company Limited v Café Chameleon CC,* the court in following the above approach to the interpretation of the policy, rejected Guardrisk's first submission, criticising the insurer's interpretation as amounting to a 'narrow peering of words'. This submission dealt with the interpretation of the clause relating to the requirement that a local authority had to stipulate that the disease had been notified to it. The court in *Café Chameleon CC* further supported the approach that the interpretation of contracts 'requires an objective

analysis, regard being had to language, context and purpose.' The court further interpreted the clauses in the insurance policy following the parameters discussed above, and interpreted the clauses in a manner which was commercially sensible, reasonably and fairly accorded with the purpose of the clause i.e. to provide cover for losses caused as a result of the risk insured.

The SCA in *Guardrisk Insurance Company Ltd v Café Chameleon CC* (2021) at paragraph 12, relied on and quoted the following quote from *Centriq Insurance Company Limited and Oosthuizen* (2020):

> ' [I]nsurance contracts are contracts like any other and must be construed by having regard to their language, context and purpose in what is a unitary exercise. A commercially sensible meaning is to be adopted instead of one that is insensible or at odds with the purpose of the contract. The analysis is objective and is aimed at establishing what the parties must be taken to have intended, having regard to the words they used in the light of the document as a whole and of the factual matrix within which they concluded the contract.'

Following the approach of the court in the *Natal Joint Municipal Pension Fund v Endumeni Municipality,* the conventional approach to interpretation, by firstly conducting an assessment of the meaning of the document, then relying on rules of interpretation to justify the meaning, must be abandoned. This approach tends to use the conclusion as a means of interpreting the document with the aim of justifying the conclusion. *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2010] ZASCA 13 ; 2012 (4) SA 593 (SCA), requires judges to provide reasons, linguistic and contextual, justifying the basis of the decisions regarding questions on the relevant document. This encourages greater transparency of the decision-making process. Once there is greater transparency of the contextual issues which were considered to make the decision, it opens up avenues for the consideration whether the material considered is legitimate and justified. Objective evidence will be available to enable litigants and appellate courts, to determine whether the decision made was based on correct contexts and facts. This approach supports the principle of a 'single reasonably clear standard for the interpretation of documents'. The process of interpretation is thereby simplified and interpreters will no longer face the impossible question of how to interpret a document (Wallis, 2019; *Natal Joint Municipal Pension Fund v Endumeni Municipality,* at para 18).

> 'Interpretation is the process of attributing meaning to the words used in a document, … having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all

these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible … results or undermines the apparent purpose of the document. … [B]e alert to, and guard against, the temptation to substitute what [you] regard as reasonable [or] sensible for the words actually used [for] to do so is to cross the divide between interpretation and [divination]. … The 'inevitable point of departure is the language … itself', read in context and having regard to [its] purpose … and the background to the preparation and production of [this] document'.

6.3.3 Interpretation using ordinary, plain meaning of words

The ordinary, plain meaning rule, requires that text is interpreted according to the ordinary meaning of the language of the words. Following this approach, ultimately prevents the interpretation being clouded by legislative or political issues. This means that the meaning of the document, must be determined from the language of the document and not extrinsic evidence must be considered. This narrow approach to interpretation, does not align itself to the approach of the South African courts as analysed in 7.2 above.

The 'plain meaning rule' requires that words are given a reasonable interpretation and that the fullest meaning is attributed to the words. This automatically gives meaning according to the natural and ordinary import of language. No fictional or forced construction is attributed to the words being interpreted, which in effect would limit or extend the scope of operation of the words. The words are not given their narrowest meaning, nor is the meaning extended to consider factors surrounding enactment. As concluded by Sither (1948), by including extrinsic evidence and opinions, doubt and ambiguity will be accentuated. He concludes by suggesting that the 'plain meaning rule' should be only be departed from only when 'the legislative intent is clear, strong and imperative'. The question then to be considered is whether this should be the approach when interpreting contracts.

The 'plain meaning rule' is strictly applied, can have an unforgiving outcome. Without considering substantive policy or social principles, courts are required to take decisions without due consideration of the repercussions of decisions (Lasky,1999). Relying on the 'plain meaning rule' often results in ambiguity and confusion. Often, the plain meaning of the words is unclear. Another challenge with this rule, is when absurd results are produced or internal conflict result with the application of this rule. In these instances, the context may assist to determine the meaning of the words used in the document. Plain meaning of words is usually assigned within the experience of the person who is interpreting the words. Accordingly, the meaning of the words will only be attributed the same meaning by interpreters who have the same experience (Lasky, 1999).'The plain meaning rule plays an important role in judicial decision making, but it must not play that role in isolation.' (Lasky,1999).

> ‘Policy and social issues are presented to the courts with the expectation that they will be considered in rendering a fair and just disposition. Relying solely on the meaning of words can never accomplish complete justice. "No word can capture the full richness of human existence, and hence there is always 'much more out there' than any word can represent”’ (Lasky, 1999).

Interpretation of contracts has developed over time. As is evidenced with the analysis above, the process of interpretation has become more practical, common sense, attributing the ordinary grammatical meaning to the text, which is consistent with the consideration of the circumstances surrounding the inception of the contract which affected the formation of the contract. The nature and purpose of the contract must be included in the process of interpretation to give context to the formation of the contract. This approach has been confirmed in the case of *Commissioner, South African Revenue Service v United Mangenese of Kalahari (Pty) Ltd.*

6.3.4 Is the terminology used clear and specific enough

The heart of the insurer’s reasoning for refusing to pay claims submitted by *Café Chameleon,* is that the business interruption was caused by government’s action ordering the lockdown and not the pandemic itself. Further Guardrisk refuted the existence of a causal link between the lockdown regulations and the Infectious Disease Extension (IDE). The insurer challenged the claim on the basis that it was not insured under the IDE. Insurance Claims Africa CEO Ryan Woolley said in a podcast with Alec Hogg (2020), that insurers are:

> ‘putting words into the intention and meaning but when you read the plain words on the contracts, its undeniable that these policies were there to cover. If you’re insuring a notifiable or contagious infectious disease, you’re contemplating the fact that the government is going to intervene, that they are going to be quarantine measures’.

The question that must be considered is whether the terminology used in these clauses clear and specific enough? The infectious diseases clause which was the subject of the essential dispute between the parties in the *Guardrisk* case, states that the insured is indemnified for

> ‘loss … resulting in interruption(of) the business due to notifiable [disease] occurring within the radius of 50km of the premises’ Guardrisk Insurance Company Ltd v Café Chameleon ; 2020). A notifiable disease was defined under ‘special provisions’ of the policy as ‘illness sustained by any person resulting from any human infections or human contagious diseases, an outbreak of which the competent local authority has stipulated shall be notified to them.’.

In the case of *Ma-Afrika Hotels (Pty)Ltd v Santam Limited,* the relevant business interruption section stated the insured is covered for losses ‘…*occasioned by the occurrence*

of a notifiable disease in the form of Covid-19 occurring within the radius of 40 kilometres of the insured premises.' The infectious disease clause extends business interruption coverage losses "*due to"* amongst other things, a "*Notifiable Disease occurring within a radius of 40 kilometres of the premises"* and the relevant part reads as follows:

> 'Infectious Diseases/Pollution/Shark and Animal Attack Extension Loss as insured by this Section resulting in [from] interruption or interference with the Business due to
>
> (a) …
>
> (b) Notifiable Disease occurring at the Premises or attributable to food or drink supplied from the Premises
>
> (c) …
>
> (d) Notifiable Disease occurring within a radius of 40 kilometres of the Premises
>
> (e) …
>
> Special Provisions
>
> (a) "Notifiable Disease" shall mean illness sustained by any person resulting from
>
> (i) …
>
> (ii) Any human infections or human contagious disease an outbreak of which the competent local authority has stipulated shall be notified to them
>
> Excluding Acquired Immune Deficiency Syndrome (AIDS) or an AIDS related condition.'

Santam submitted that the loss suffered by the insured was because of the lockdown and/or the general concern of fear of the public. Santam rejected the claims on the basis that the loss was 'not caused by the Notifiable Disease occurring within the 40 kilometre radius of the business premises.' Following the purposive approach to interpretation, the court interpreted the policy wording in a way which ensured 'a fair, sensible and business-like outcome.' The court did not merely rely on the wording of the policy and in order to achieve this outcome, but had to employ the purposive approach which required consideration of what the purpose of the policy was. On a strict interpretation of the wording, it would imply that only if the notifiable disease occurred within the 40 kilometre radius, would the clause be triggered. This is not however, the manner in which the court interpreted this clause.

The disputed clause in the case of *Interfax (Pty) Ltd and Luggage Glove CC v Old Mutual Insure Limited* is whether the applicant's business was interrupted in consequence of the loss caused by a contagious or infectious disease within a 50 km radius of its various premises referred to above which in turn triggered a regulatory response. The disputed clause headed 'Murder, Suicide, Food Poisoning' etc. reads as follows:

‘Loss resulting from interruption of or interference with the business in consequence of the following events, shall be deemed to be loss resulting from Damage (as defined)–

(a)	murder or suicide food or drink poisoning	))	at the premises of the insured
(b)	vermin, pests or defective sanitary arrangements at the insured’s premises	)))))))))	provided that the local, regional, municipal or government authority responsible for the area has declared a notifiable medical condition or communicable disease to exists within the area and/or has imposed quarantine regulations and/or to restrict access to the area in terms of any local, regional, municipal, or
(c)	contagious or infectious diseases at the premises	))	national law or byelaw or regulation pertaining to public health and safety
(d)	contagious or infectious diseases within a 50 km radius of the premises	))	
(e)	shark scare	)	
		)	within a 50 km radius of the premises

(f)	oil pollution	)	

Further, there is a proviso in respect of paras (b), (c) and (d) of this clause which reads:

> 'Provided that the local, regional, municipal or government authority responsible for the area has declared a notifiable medical condition or communicable diseases to exist within the area and/or has imposed quarantine regulations and/or acted to restrict access to the area in terms of any local, regional, municipal or national law or bye-law or regulating pertaining to public health and safety.'

6.3.5 The contra proferentem rule

The rule generally means that in the event of doubt as to the meaning of a contract, the text will be interpreted against the person for proposed the words used. Insofar as any ambiguity exists in a contract, the application of this rule means that the text will be interpreted in favour of the policyholder in the case of an insurance policy (*Fedgen Insurance Ltd v Leyds,* 1995). Insurance contracts should be construed 'reasonably and fairly' as they are 'contracts of indemnity'. Any 'provisos will be strictly construed against the insurers because they have for their object the limitation of the scope and purpose of the contract' (*Norwich Union Fire Insurance Society Ltd v SA Toilet Requisite Co Ltd*, 1924 at page 222).

The purpose of business interruption policies is to provide the insured cover in the event of the business being interrupted due to the outbreak of an infectious notifiable disease. The occurrence of the disease must be local which in tune triggers a response from the authorities that results in a disruption of business (*Ma-Afrika Hotels and Another v Santam Limited,* 2020 at par 40).

In the *Guardrisk Insurance Company Ltd v Café Chameleon* (2020) case, the court found that there was a direct causal link between the pandemic and government intervention aimed at curbing the spread of the virus. Further, that the latter was the cause of the loss sustained by the insureds. Cloete J in *Ma-Afrika* case (para 8.4), stated the following:

> 'Because insurance contracts have a risk-transferring purpose, any provision such as an exclusion placing a limitation upon an obligation to indemnify is usually restrictively interpreted, since it is the insurer's duty to spell out clearly the specific risks it wishes to exclude. In the case of "real ambiguity" the contra proferentem rule applies, and such a clause is construed against the insurer'.

6.4 Problem of policy wordings

The outcomes of the various cases involving business interruption insurance, has indicated globally that ultimately it is policy wording that determines the parameters of cover provided. Wordings as alluded to above, are subject to a wide range of various differing interpretations. Generally to date, most cases have been decided in favour of policyholders. In the USA, the situation is different, as the trigger required in US policies, requires a direct physical loss. South African insurers have consistently denied liability arguing that the Covid-19 pandemic may have caused interruption with the business, but denied that this triggered liability for cover in terms of the policies. In order to ascertain whether liability is proven for cover for business interruption, a deeper consideration of the policy wordings must take place, and the application of applicable legal principles must be clearly identified.

6.4.1 Lack of consistency of policy wordings

The one important aspect of business interruption insurance policies which came to the fore during Covid-19, was the wide scope of the wording which were used in these type of policies. Generally the three categories are, disease, prevention of access or a hybrid of the two previous categories. The lack of consistency between various policy wordings was considered in the *FCA v Arch Insurance (UK) Ltd and others* test case. The litigation resulting from the repudiation of these claims for the damages sustained as a result of the Covid-19 government lockdown, emphasised the extremely narrow approach taken by insurers to such claims. The majority of these claims were rejected, and the debates on the meaning of the policy wordings were lengthy and complex (Farnell,B, Price, S & Salkeid, JJ, 2021), with much of the focus being on the policy wordings and with little or no focus on the fundamental principles of business interruption insurance.

The Multimark III Policy, commonly used in South Africa, is a long and complex policy with numerous extensions, with lengthy and complex wording. The South African courts, followed the approach of the UK cases, and also place much emphasise on the interpretation of the policy wordings. The result of these decisions, made it more likely that the business interruption policies currently being used, will provide cover for business interruption losses, in instances where these losses are firstly not strictly covered as they are not insurable, and secondly, they were nor considered by insurers to be covered by the existing policy wording as cover would only be provided once the insured had suffered some physical loss.

The judgements although clarify a number of ‘key contractual uncertainties’ (Farnell et al, 2021), such us causation, and provide greater certainty in respect of business interruption

cover, do not provide a carte blanche approach to the acceptance of all business interruption claims. In instances where there are clear exclusions, claims will not be accepted (Farnell et al, 2021). The wordings of policies will still have to be considered on an individual basis, and losses will still have to be quantified in consideration of the applicable trends clauses.

The FCA test case judgment, with the jurisprudence that has developed following that judgement, does make it more difficult for insurers to repudiate claims for business interruption losses, or to reduce liability for payment of those claims. The FCA test case, 'provides authoritative guidance for the interpretation of similar policy wordings and claims' (Farnell et al, 2021).

6.4.2 Challenges faced with different policy wordings

In *Guardrisk Insurance Company Ltd v Café Chameleon* (2020), Guardrisk rejected the claim on the basis that the insured's loss was not covered under the NDE clause. The submission was that the direct cause was the lockdown as imposed by government regulations. The High Court interpreted the clause in a manner which resulted in a fair, sensible and businesses-like outcome. General concerns about the impact of Covid-19 on the insurance industry, were also rejected.

The liability of an insurer must be determined in accordance with the terms and conditions of the contract. The approach of the UK High Court in the *FCA v Arch Insurance (UK) Ltd* test case, found that insurers must pay the claims and applied the principles of Treating Clients Fairly (TCF) within the parameters of the policy wording. The High Court in this case, closely considered various policy wordings in order to ascertain whether non-damage business interruption was covered. A summary of the high level findings of this case include:

- Where it could be shown that the loss suffered was caused by Covid-19 from the date when the disease was diagnosed within the prescribed radius of the business, through actions, measures and advice of the government or public reaction, then the policy would react and provide business interruption cover.
- In instances where the policy required an 'event' to happen which was defined as the trigger, then the occurrence of disease at different times and in different places would not be considered as the same event, then the policy would not react and no cover would be provided.
- A distinction was made by the High Court, between instances where businesses were required to close and where businesses whose employees elected to stay home resulting in a drop of turnover. Cover would only be provided in instances where a public

authority or government intervened, and placed restrictions in respect of the insured's business.

- From interpretation of some of the trends clauses, it became evident that the Covid-19 pandemic and the government response were considered as a single cause. Where the loss caused by an insured peril had been established, unless so required by the policy wording, it seemed illogical for the loss to be limited by the inclusion of any part of the insured peril in the assessment of what the position would have been if the insured peril had not occurred.

In *Ma-Afrika Hotels and Another v Santam Limited,* 2020*,* Santam proposed that an insured peril must be identified within the context of the policy wordings. Only then can it be established that an insured peril is the proximate cause of the business interruption and resulting loss. It emphasised that the operative cause of the loss or dominant effect, is the proximate cause. This means 'although Covid-19 may have been widespread, the extension requires that the local occurrence of a notifiable disease must cause the interruption of the applicant's businesses and losses'. To be insured under the perils under the extension for business interruption, the global pandemic and resultant lockdowns, were not considered by Santam to satisfy the requirement of the proximate cause.

Similarly, in *Guardrisk Insurance Company Ltd v Café Chameleon* (2020), this argument was made by Guardrisk in the case. Guardrisk alleged that global pandemics and their consequences, including national government lockdown, are not covered by the infectious disease extensions. Santam criticised the decision against Guardrisk (June 2020 decision) on the following bases:

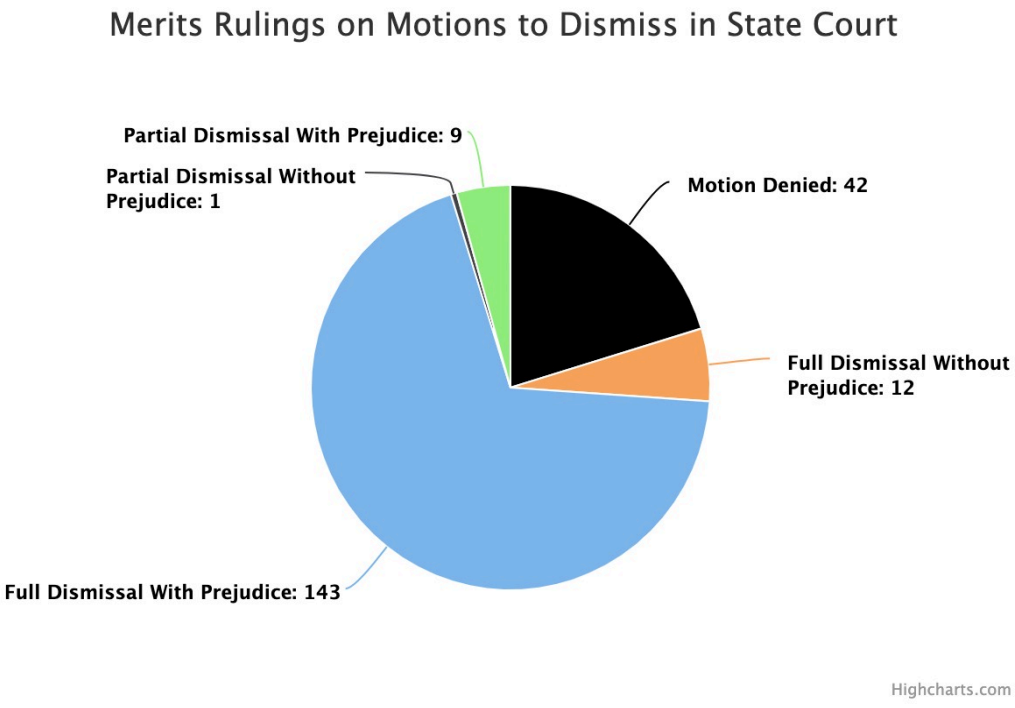
- No particular attention had been given to the 'language of the policy, the local nature of the insured events of that the notifiable disease peril which caused the loss should be one occurring within a prescribed radius';
- The loss and business interruption was a direct result of the lockdown regulatory regime. The allegation was that the wrong counterfactual had been identified ;
- In determining that factual causation had been established, the court in Guardrisk failed to consider 'whether the local occurrence of Covid-19 was the dominant and therefor the proximate cause of the loss';
- The court did not consider the 'trends clause'. Santam submitted that the importance of the trend clause, was that it was of importance to the construction of the policy. The

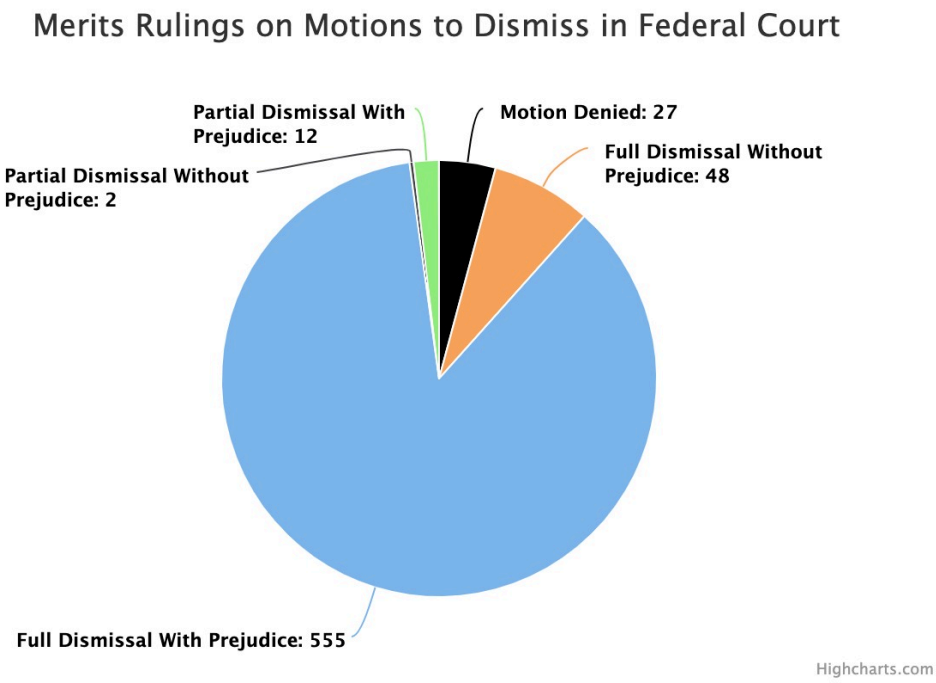
insured peril according to this argument, must have caused the business interruption loss, thereby applying the 'but for' test.

Considering the trends of the decisions discussed aforesaid, it can be safely concluded that the decisions consistently indicate that the policy wordings provide sufficient cover for instances where government intervenes in order to respond to disease generally, including where lockdowns are imposed. The proviso is that there is a local outbreak. It is very unlikely that a court subsequently will make a different decision based on these facts (Africa Re, 2021).

6.5 USA Litigation

The courts in the US have generally not followed the same approach as those in the UK and South Africa since the USA litigation has not involved the contagious disease extension. The litigation has involved the main policy which required physical damage. Generally the cases have been dismissed without going to trial. Cases have been dismissed on the motion to dismiss.





Covid coverage litigation tracker: 20 July 2022. https://cclt.law.upenn.edu/

In the case of *KC Hopps Ltd v The Cincinnati Insurance Company* (2021, pg. 13) (a full analysis is attached as Annexure "G"), the court stated the following:

> 'As demonstrated above, to the extent that Plaintiff has suffered a loss, it was caused by compliance with governmental orders that impacted its business operations and not by "a physical alteration, physical contamination, or physical destruction" of Plaintiff's property. Thus, because there is no direct physical loss or damage here, there should be no reason to reach the Policy's exclusions. However, even if one of the governmental orders under consideration could have caused direct physical loss or damage, there would be no coverage under the Policy because one or more of the Policy's exclusions apply.'

The issue in the US has been clear; since Covid-19 did not cause physical damage, and indeed most insureds did not allege physical damage, the policy does not respond.

The *KC Hopps* case, was the first case where the jury agreed with the previous summary judgments or motion matters, where the approach of the courts was that business losses resulting from the Covid-19 government lockdown, did not amount to 'physical loss' or 'physical damage' to the insured property. This has generally been the approach of the USA courts in cases which followed the case. However, there have been different outcomes based on various policy wordings and different approaches across states.

In the case of *Santo's Italian Café, LLC v. Acuity Ins. Co* (2021) (21-3068 (6th Cir. Sept. 22, 2021), the insured argued that although Covid-19 did not physically affect or directly damage or change the insured premises, that the lockdown orders of Ohio federal government, had affected the use of the premises and had deprived the insured of the use of its property. It argued further that the deprivation of this specific use was covered by the 'physical loss' or 'physical damage' requirement. The Court held that COVID-19-related governmental orders 'simply prohibited one type of dining,' they did not create the required 'direct physical loss of property' or 'direct physical damage to' property 'that is a precondition for the business suspension coverage in the policy' (Order at pp. 5 and 9).

The court in *Novant Health Inc. v. Am. Guarantee & Liability Ins. Co*., (21- CV-00309 (M.D. N. Carolina, Sept. 23, 2021), held it was inappropriate to dismiss Novant's complaint because:

- 'Novant adequately alleged direct physical damage or loss'.
- 'Whether COVID-19 has resulted in direct physical damage or loss to Novant, and if so to what extent, are questions better evaluated on a developed factual record'.

The Appeal court of the State of California was also faced with the question of whether a policy covering commercial property provides coverage for loss of business income due to Covid-19, in the case of *The Inns by the Sea v. California Mut. Ins. Co.*, 71 Cal. App.5th 688 (November 15, 2021). It was pointed out by the court that this issue had not come before a California Appellate Court, that this issue had been considered by numerous Federal Courts. The majority of the decisions of those courts had not found in favour of insureds and found that there was no possibility of coverage (Dinnie, 2021c). Once again the court held that it had considered the insured's allegations that Covid-19 was on the premises, no physical damage or loss had occurred, causing the business to close its doors. The cause of the lockdown was government orders. On this basis, the claim was repudiated (Dinnie, 2021c). It was further argued that the failure to include an exclusion clause in the policy, was indicative of the intention of the insurer to cover for virus losses. The court dismissed this argument and stated that the fact that there was no exclusion clause did not create ambiguity and the effect was not that coverage was included. (Dinnie, 2021c). The point is made by Dinnie, that this position is no different in South Africa.

In contrast to the decisions aforesaid, the court in the case of *Studio 417, Cincinnati Insurance Co, The Inns by the Sea v. California Mut. Ins. Co.*, (71 Cal. App.5th 688 (November 15, 2021)), the insurer's motion to dismiss was denied. The reasoning was that the beauty

salons and restaurants alleged that Covid-19 ‘attached to and deprived the plaintiffs of their property, making it unsafe and unusable, resulting in direct physical loss to the premises and property.’

There have been numerous cases in the US in various states, which have generally followed the approach aforesaid. Without the ‘physical damage’ or ‘physical loss’ being sustained to the insured premises, the coverage is not triggered in terms of the policies.

6.6 Conclusion

As this dissertation focuses on the UK and South African cases, a detailed analysis of the USA cases has not be undertaken, nor is it necessary since the US merely demonstrates the 120 year old existing position. Business Interruption insurance was introduced to cover revenue losses arising out of damage to insured property. In the US without the insured property being damaged there is no claim. The issues in SA and UK have been different but the aforesaid has been included as a general comparison illustrating the different issues facing the UK and South African courts.

The USA courts, as is emphasised above, took cognisance of the fact that in business interruption policies, business interruption is provided in instances where physical loss or physical damage is sustained to the insured premises. To emphasise the point, where no physical loss or physical damage has been suffered to the insured premises, the cover is not triggered and accordingly, a claim for business interruption loss or damage will not be paid.

The two distinct categories of business interruption policies respond in different ways to policyholders claims relating to business interruption losses due to the Covid-19 pandemic. Standard business interruption insurance, those policies which the USA courts considered, required physical damage or loss to the insured premises as the claim event. In South Africa, this is the most common form of business interruption cover (Fourie, 2020). The approach of USA insurers, is where there is no physical loss or damage caused to the insured property and accordingly, claims made under this cover have been repudiated. The second type of policy is where business interruption cover is provided and where there is an extension to the policy covering infectious diseases or contagious diseases. These are referred to as notifiable diseases with a usual prescribed radius covering the area around the insured premises (Fourie, 2020).

The central issue which has been focused on by South African courts, as cited by the High Court in *Ma-Afrika Hotels and Another v Santam Limited* case, is the interpretation of the policy wording. The focus was ‘ specifically with reference to the nature and scope of the insurance peril and whether the cause of the insurance event, being loss of income, was due to

Covid-19, "the notifiable disease" or the Government enforced lockdown' (Fourie, 2020). With the interpretation of insurance policies evolving towards a 'practical and common-sense approach', the meaning is then influenced consistently with the '*surrounding circumstances known to the parties at the time of the formation of the contract and considering the nature and the purpose of the contract. Consequently, and intentional approach to the interpretation of the policy wording is required, in a manner that provides an interpretive outcome that is fair, sensible and business-like'* (Fourie, 2020).

As pointed out by Fourie (2020), the cases referred to highlight threats to insurers in the area of business continuity insurance. The importance of clarity of the wording of the policy and agreement of the calculation of the quantum of claims is emphasised. The point has been made by insurers that the potential of large claim pay-outs, will place Solvency Capital Requirements (SCR) under pressure (Fourie, 2020). The wordings of policies will be amended with the intention of reducing instances where the wording of policies are unclear and complex issues of interpretation arise in the determination of whether cover is provided (Fourie, 2020).

7 CRITICAL ANALYSIS OF THE EXISTING TEXTBOOK: THE LACK OF A PRINCIPLE BASED APPROACH

The leading textbook on consequential loss is Cloughton (1985) *Riley on Business Interruption and Consequential loss Insurance Claims,* now in its 11th edition It focusses on the different mechanisms for the calculation of the consequential loss surveying practices in different countries. It provides a practical analysis of business interruption and consequential loss insurance and much focus is placed on the claim. It is noted that the textbook did not play a significant role in the litigation for business interruption during Covid-19.

The 11th edition, post Covid has recently been published. As indicated the latest edition deals with the Covid-19 litigation. Surprisingly the earlier edition, the 10th edition played virtually no part in the Covid-19 litigation. Its part was to confirm there was no general agreement with the *Orient-Express* case. The focus of the book is on the practice and the procedures of this type of insurance. In the practical approach, focus is placed on various types of cover and extensive explanations on over two hundred charges in company accounts. Much of the focus is on financial aspects of business interruption and consequential loss cover. Thirty other perils and contingencies apart from fire, including labour action, strikes and riots are considered. As already indicated this policy is regarded as the most complex of all property and causality policies and this book plays an important practical role in the market place. If there is a criticism to be levied is it lacks a clear historical and conceptual approach to the policy.

Cloughton conducts an extensive international comparative commentary between the approaches and processes applicable in the a large number of jurisdictions, which provides a good commentary on the international approach to these policies. But the focus is on the various accounting methods of each. The calculation of claims and how they are processed is considered, the differences between the various countries. The standard policy wordings used in a few jurisdictions, UK, US, Asia, Africa, the Americas and Australasia are considered and compared. It provides a reference guide in it addresses practical questions to problems which are faced in practice.

However, the gap which is identifiable and which is not adequately covered in the textbook, is the theoretical basis of the business interruption or if you like, the consequential loss policy and its historical background.

One example will illustrate the point at paragraph 10: 'The perils insured against are the same as those covered under the standard fire policy'. This is the commonly articulated view, but it is simply incorrect, conceptually and factually. The peril of the consequential loss is damage to the property. It is this damage which causes the consequential loss. As indicated above, the consequential loss policy exists conceptually (and factually) because the property damage insurance does not cover consequential losses. The property damage policy needs to be augmented by a consequential loss.

The entire history explaining the above is not included in the textbook. The 11th edition which has just been released is not dealt with in this dissertation. The 11th edition looks at the principles, conditions, and available scope of modern consequential loss policies, including the pitfalls, and includes key recent case law. The contents of the 11th edition are as follows:

- Business Interruption Risk and Insurance – Introduction
- Policy Overview
- Additional Clauses and Extensions
- Legal Principles Relevant to Business Interruption Claims
- Risk Management and Self Insurance
- Selecting the Right Cover
- The Maximum Indemnity Period
- Calculating the Amount to be Insured
- Market Sectors and Specialist Risks
- International Considerations
- Claims – The Process and Mitigation of Loss
- Claims – Evidencing Quantum
- Claim Settlements – Issues that Arise in Practice
- Current and Future Developments

The 11th edition comes at a critical time, when in the aftermath of the Covid-19 litigation, particularly the FCA test case, the decisions of the courts need to be considered and addressed. The significance of the FCA test case decision cannot be under estimated in respect of the impact it has had on business interruption insurance globally, and on the impact this decision has had on policy-holders and insurers alike who have been affected by the Covid-19 pandemic. The new features of the 11th edition include:

- Extensive restructuring of the chapters to improve accessibility and usability.
- A new legal chapter addressing the Insurance Act 2015, damages for late payment, the 2021 FCA test case and the implications of this for causation under business interruption policies.
- New commentary on parametric and pandemic / epidemic cover.
- Business interruption extensions have been brought together in a single chapter, discussed in more detail and now addressed in practical, alphabetical order.
- Expanded consideration of cyber threats and the cover available.
- Updated discussion of all perils, including riot damages and terrorism.
- It offers guidance on policy wordings, the extent of coverage, and legal analysis of claims in the UK and US – comparing these models with other jurisdictions.

Other features of the 11th edition include:

- An examination of the practice, strategy and procedure of business interruption insurance.
- Provides broad insight from a legal, insurance and accounting perspective with expert analysis and practical examples.
- Covers more than 30 perils including pandemics, explosions, earthquakes, riots, malicious damage, floods, theft, fire and more.
- Looks at standard policy wordings and defines key terms, highlighting common pitfalls and providing example settlement formulas.
- Analyses the means of establishing the basis of cover required.
- Covers all aspects of claims processes, calculations, and settlements.
- Takes an international view of business interruption and global insurance programmes.
- Compares worldwide business interruption cover in 30 countries across Europe, the Americas, and Asia-Pacific.
- Comparative analysis of the UK and US models and the policy wordings in both jurisdictions.
- Details different accounting strategies such as the examination of income streams, gross profit, gross earnings, and determining adjustments to turnover.
- Explains how recurring claims issues can be addressed by the wording of the policy and how they can be resolved in practice.
- Guidance on over 200 charges in company accounts.

8 DISCUSSION: CAN COVID-19 RISKS WITH LOCKDOWNS BE INSURED

Policy makers and regulators globally are considering and should continue to consider innovative measures which could respond to the potential gap in existing business interruption coverage for losses relating to pandemics such as Covid-19. Covid-19 involving a world-wide lockdown is unprecedented. The governmental lockdowns globally forced many companies to claim under their business interruption insurance policies for significant losses. Due to the global effect of the pandemic, the basic principle of insurance being *The Law of Large Numbers* cannot be applied (Wood, 2021).

> 'Pandemics are uninsurable because they basically breach one of the foundation stones of insurance and that is the principle of large numbers - a large number of people put a premium into the pool and in any year only a small number of people take out in terms of a claim. When you have a pandemic then everybody, if there was cover, everybody would be taking it out," said Scofield.' (Wood, 2021)

The risk of the large number of accumulated losses cannot be sustained by the smaller number in a group, or even the entire group itself. Significant catastrophic losses suffered by a large group, being single events all accumulated together, cannot be pooled. The risk cannot be diversified and spread as the large number has been affected by the insured single event. The communities so affected are then responsible to share the losses and government plays the role of manager to control such losses (OECD, 2021; Bikhani, 2021; Penas, Eisenburg & Sahin, 2021). Insurers play a role in management of risks and insure certain types of risks by providing products which are innovative and provide insurance products for risks even for ones that may have previously been uninsurable (Penas, Eisenburg & Sahin, 2021).

The point to be emphasised is that the interpretations of the UK and South African courts of business interruption policies were not aligned to the principle of insurability and thus intention of insurers which is to provide cover for insurable risks. The saving grace is the policies involved were those containing extensions, used in a specialised market. This is a smaller set of the larger numbers of insureds. Insurers did not anticipate the contagious disease extension would be triggered in a world-wide lockdown. The importance of policy wording clearly indicating what is covered, cannot be understated. As a result of the judgements made by the UK and South African courts, reinsurers responded quickly by making amendments their policies to exclude Covid-19 type of risks. These amendments were already in place by the time the *Ma-Afrika* case reached the SCA. These amendments would in any event be

imposed by reinsurers in terms of their treaties with direct insurers. The bulk of the claims costs were borne by reinsurers. Considering the reaction of government and the regulatory authority discussed below, the reaction of insurers was not surprising (OECD, 2021a).

What is evident, is the following: insurers cannot provide unlimited insurance for an indefinite types of losses but they can play a role and assist to protect society from pandemics. Insurers will now be required to consider different solutions to be offered to insureds, providing the required cover for future events similar to the Covid-19 pandemic (Penas, Eisenburg & Sahin, 2021). The question on whether there should be cover for business interruption losses suffered as a result of a pandemic is being considered and debated globally. The issue of the role played by public policy is an important one to be included in the process of answering this question. In the process of answering this question, the role further that government intervention plays cannot be ignored, because fundamentally, business interruption insurance for a losses caused by a pandemic supported by a lockdown, are uninsurable. A SASRIA type solutions may be the way to go, where solutions against pandemic risk with the aligned united government reaction, are covered (Bikhani, 2021; Wood, 2021). It should be recalled however that the government has had to bail out SASRIA. There can thus be little doubt that a SASRIA type of solution will result in the cost being transferred to the government.

In addition, in reconsidering their reinsurance programs, insurers had to consider the manner in which to quantify their potential losses (OECD, 2018). This was addressed in the reinsurance market, with the use of a mechanism requiring insurers to contribute 10% of the loss suffered under their catastrophe treaty programmes, which was included at the time of the renewal of the policy. Annual renewed treaties included the requirement of an additional premium to provide this cover.

In September 2021, Santam released its Insurance Barometer. John Melville, Santam's executive Head of Underwriting Services, Reinsurance and International noted the following (Bikhani, 2021; Wood 2021):

> 'The pandemic is proving to be more than a passing risk event. Instead, it has turned out to be a powerful catalyst of other systemic risks which combined make insurance less affordable. … [R]einsurers have increased the premiums they charge insurers for catastrophe cover. They also moved quickly to exclude pandemic risk from their cover." In global markets. Nicholas Scofield, Chief Corporate Affairs Officer for Allianz Australia indicated "When you've seen some of these new wordings, there's not a cigarette paper, or a crack of sunlight in some of these revised infectious diseases wordings through which someone could even dream that a claim would be

possible … [E]verybody is tightening that up. There won't be much doubt when the next pandemic comes about whether there's cover or not. I don't think it will warrant a test case'.

Insurers offering business interruption coverage have considered whether coverage is applicable to Covid-19 losses particularly in light of a governmental lockdown. Insurers offering business interruption coverage, must make a list of covered perils and must clearly indicate whether a civil authority, contingent business interruption or supply chain coverage is included, and must describe the type of damage or loss required for coverage and specifically whether a loss of access to the insured property in connection with Covid-19 is sufficient for coverage to be triggered. Unless the peril causing the damage or loss is clearly defined , based on the *contra proferendum* rule, the contract will be interpreted against the insurer.

8.1 Does the issue of social obligation of insurers and public policy play a role during pandemics ?

It cannot be denied that insurance serves an important function in society. It serves a 'quasi-public function as a societal safety net by transferring risks from individuals to a larger group of community' (French, 2020). Without insurance, individuals and businesses would face complete collapse if they suffered loss as a result of a catastrophe, were unemployed for a period of time or suffered a critical illness or disability. The transfer of risk from an individual to a larger group is a mechanism supported by public policy to manage risks (French, 2020). Businesses which were forced to close down during Covid-19 suffered 'an injury' and if not compensated for this loss by business interruption insurance, would be prejudiced and public policy which calls for compensation to injured parties would be frustrated (French, 2020).

Policyholders pay their premiums annually to insurers and anticipate that insurers will honour their promise to compensate for loss sustained as a result of the insured event. Public policy also supports the enforcement of contractual and legal obligations. As pointed out by French (2020), this means that insurers should 'bear the financial burden of losses when losses occur'. The prevention of damages and injuries are further supported by public policy, and this is the principle that underlies the criminal justice and delictual systems (French, 2020). It has been pointed out that this is the principle which was the basis upon which government issued national lock-down orders and issued disaster management orders i.e.. to prevent unnecessary deaths (French, 2020). These are indicative of a proactive approach to mitigate against injuries or deaths, which is favoured by public policy.

French (2020) makes the point that it is immaterial that a business is shut down because it actually was contaminated by Covid-19, as public policy dictates that when government

orders a lock-down and imposes disaster management regulations, shutting down the business, this should also be covered. If not, then business would then wait until their businesses actually test positive before shutting down and complying with the lockdown orders. Potentially the liabilities in this instance are far reaching.

So the question then which needs to be considered, is whether the social obligation of insurers as discussed above, and further if the issue of public policy demanded or placed undue pressure on the perception that insurers must be held to contract to provide indemnity in the event of pandemics. This perception and approach was not based on an understanding of the principles of insurance and insurability, yet could it have played a role in the decisions made by the courts to award compensation for the losses sustained as a result of the Covid-19 lockdown?

The correct answer based on the arguments in this dissertation, can only be that if the principles of insurance are accounted for, such obligations and public policy as perceived, cannot and should not play a role or impact in the decision of whether insureds are covered as a result of consequential loss suffered as a result of a pandemic.

8.2 The role of innovation in insurance to deal with future pandemics

> 'An actuary's almost knee-jerk reaction to a pandemic is to model it. However, this temptation has to be moderated and an actuary must consider the implications of other important factors in planning for future pandemics. On the one hand, the legal aspects of insurance policies might outweigh any actuarial considerations. On the other hand, developing models for future pandemics based on the most recent one bears the risk of preparing for the last war. The next pandemic will most certainly be different' (Boado-Penas, Eisenburg & Sahin, 2021).

Covid-19 has been a significant event which it is anticipated will have repercussions for the future. The resilience of the insurance industry has been demonstrated in the manner in which the industry has absorbed the losses which have been substantial and catastrophic. The insurance industry has been the support which has assisted to restore many business to a level of normality, in economies that have been hard hit by the pandemic (OECD, 2021a).

The insurance industry has demonstrated the important function it plays in the economy regardless of interruptions which could be devastating. Important lessons have been learned from the Covid-19 pandemic (OECD, 2021a). The importance of policy wordings and the certainty of contract has been emphasised. The intentions of the parties to insurance parties

must be clearly reflected in the policy wording. In addition, insurance has a role to play and to be innovative and develop products which are innovative to anticipate future pandemics.

Insurers face challenges on a daily basis with changes in the commercial space. Commercial insurance is limited by both severity and prevalence of the damages. The test which Covid-19 put the insurance industry through is the extent and effectiveness to the industry's existing products. The role of insurance is not to provide social support for undefined and unlimited damages, as this societal protection is the role and responsibility of government, insurance could also play an important role in its contribution to pandemic responses, by insuring some of the damages suffered during a pandemic (OECD, 2021).

Insurers need to consider responses which are innovative which may include considering converting or adapting existing products to provide cover for pandemics. Pandemic exclusions had previously been added to business interruption insurance, but these should possibly be revisited and revaluated to be included in business interruption cover with an appropriate premium rate. The insurance industry through its conduct by repudiating business interruption claims lodged as a result of Covid-19, has lost public trust. In response to the litigation on the claims for business interruption insurance globally, insurers have amended their policies to include pandemic/epidemic exclusion clauses. Most insurers are not ready to provide cover for pandemic risks. Pandemics are rare events where everybody losses globally. Risk diversification cannot therefor be spread (Boado-Penas et al, 2021; OECD, 2021b).

The Wimbledon Tennis tournament had for the last 17 years, paid for a business interruption policy with a pandemic insurance clause which costed them around £1.5 million per year. A claim was submitted for the first time since inception 17 years ago. Paying out roughly £25.5 million (US$31.7 million) in premiums over that 17-year period, Wimbledon received an insurance pay-out of around £114 million (US$142 million) the cancelled 2020 tournament (Insurance Journal, 2020). But this is not an investment that is economically possible for small or medium businesses.

Other reputable sporting events were cancelled in 2020 and 2021. The resulting loss for the organisers was huge. It has been noted that the unprecedented disruption that occurred largely during 2020 because of national lockdowns, and which still occur currently with breakouts of Covid-19 still occurring, may cause event organisers to consider such business interruption products in the future (Insurance Journal, 2020). It may develop into an essential

product for at least event organisers both in the sporting arena and live entertainment forum. Insurers will have to address the challenges in respect of pricing of premiums because of increased demand and the level of risk which they will be required to take on. 'Insurance represents damage limitation for the competition, and it will find itself in a much stronger position than most other events in the world during this period' (Insurance Journal, 2020).

The demand for insurance cover for business interruption for new epidemic and pandemics is undeniable. Insurers are now facing challenges in which they are required to develop innovative policy structures and mitigation strategies for both the private and public sectors. The only way in which products should be developed is in partnership and in collaboration between governments, reinsurers and insurance to ensure that pandemic risks which are uninsurable, are insured through adequate insurance mechanisms (OECD, 2021b). This is the manner in which parametric pandemic insurance design for governments has introduced and should be also used to develop products to provide cover for pandemic risks (Boado-Penas et al, 2021).

8.3 Concluding comments

Government not only has the power but has the ability to assist to alleviate the financial challenges experienced by businesses as a result of losses sustained as a result of Covid-19 and the resulting regulations. By empowering the private sector and private businesses, with the support and collaboration of the insurance industry, this will take on the majority of the burden of financial losses. Government will then be required to focus on providing cover for excessive losses and market failures which in economic theory, is its function. The focus of government must be the prevention of market failure and the collapse and bankruptcy of the entire industry. Any collaborative project to provide a comprehensive solution, must ensure that such solution invariably protects insurance institutions and empowers these institutions to be resilient enough to prepare for and combat the next economic crisis (McHugh, 2021).

As aptly pointed out by McHugh (2021), and referring specifically to the US insurance industry, it is understandably from the political perspective, that the insurance industry is unpopular, and if legislation was imposed without the collaboration of the industry, without the benefit of the industry players, and without considering 'the rational economic needs of insurance companies as well', the effect of this would be detrimental to the long-term needs of the players in the insurance industry and the businesses that the industry was seeking to protect (McHugh, 2021).

9 THE IMPACT OF THE FSCA GUIDELINES TO COVID-19 CLAIMS AND TREATING CLIENTS FAIRLY ON COVID-19 CLAIMS

9.1 General introduction

There has been no unitary approach on government and regulatory intervention, in the jurisdictions of the UK and South Africa, insurers are guided by the guidelines in the Treating Clients Fairly to treat insureds in a fair and honest manner in their dealings with them. In South Africa, the Regulatory Authorities i.e. the Financial Sector Conduct Authority and the Prudential Authority, played a role ensuring that the claims for business interruption losses were paid. The effect of the litigation arising from the claims for losses resulting from the business interruption caused by Covid-19 and the national lockdown, caused delays in the payment of these claims. The Regulatory Authorities accordingly intervened, basing such intervention on the principle of the protection of policyholders and Treating Clients Fairly (TCF). Recommendations were made in terms of which insurers were encouraged to make interim payments, pending the finalisation of litigation. Interim payments were then topped up after the outcome of the cases. Once the decisions of the various court were made, and clarity was given on the obligation of insurers to pay the claims for losses incurred because of business interruption, it then became evident that insurers had to shift focus, and to consider the coverage of losses sustained as a result of catastrophes. Reinsurance coverage was considered in these cases and focused on the issue of the aggregation of claims (Bikhani, 2021).

9.2 Response of the Financial Sector Conduct Authority and Prudential Authority

The Financial Sector Conduct Authority released various communications during 2020 acknowledging the impact of Covid-19 and setting out its expectation it had on regulated entities. In FSCA Communication 12 of 2020, it recognised the uncertainty Covid-19 had created for the financial sector and the increased exposure to conduct risk as well as the increased risk that financial institutions would not treat their clients fairly (FSCA, communication 12 of 2020). The recommendation made by the FSCA was that financial institutions treat their customers with more empathy, flexibility and understanding. Recommendations of mechanisms to be used included relief and support options for vulnerable customers.

In addition, the FSCA and PA released a series of Joint Communications during 2020, specifically addressing various issues relating to the effect of Covid-19 in the financial sector.

The Financial Sector Conduct Authority (FSCA) and the Prudential Authority (PA), in Joint Communication 5 of 2020, communicated that, in respect of standard business interruption insurance policies which included a trigger being physical damage to the policyholder's premises, 'an insurer would be obliged to indemnify a policyholder for loss of income only if a policyholder is able to prove physical damage'. On this basis, in their view, 'COVID-19 will not be covered in the standard policy'. They correctly concluded that in the absence of physical damage to the insured property, as Covid-19 was not covered in a standard policy, thee Authorities decided not to intervene in the contractual relationship between insured and insurer.

They further considered the second type of business interruption policy which had the infectious / contagious disease extension. The debate which took place around these policies, revolved around what the trigger was for valid claims and 'how exclusions for pandemics should be applied' (FSCA and PA Joint Communication 5 of 2020). No definitive comment was made by the Authorities regarding these extensions and an acknowledgment was made that they 'understand' the interpretation that was given the infectious / contagious disease extension. Insurers were encouraged to provide 'clear communication' to policyholders, to 'deepen confidence and trust in the insurance sector and to contribute to the long-term economic recovery efforts' (FSCA and PA Joint Communication 5 of 2020).

Insurers were urged to continue to act in good faith towards their policyholders and to ensure that the principles of Treating Clients Fairly (TCF) were adhered to regardless of the challenges being faced during the Covid-19 pandemic and lockdown. They were encouraged to make prudent decisions in the 'spirit of solidarity' (FSCA and PA Joint Communication 1 of 2020).

The FSCA and the PA themselves, in their joint communication, raised their contentions, noting that 'insurers and reinsurers are interpreting the infectious/contagious disease extension and in relation to the COVID-19 pandemic to apply only where the loss of business income was due to the business being interrupted as a result of a localised COVID-19 infection and not as a result of other related actions such as lockdown introduced by government'.

The FSCA and PA encouraged insurers to carefully consider coverage taking consideration of all circumstances giving rise to each claim, with specific focus on the policy wording, and not to simply take a blanket approach. A list of five points expressing the expectation of the Authorities of insurers when considering the variation of contract terms and

conditions. Item c and d (Joint Communication 5 of 2020) are strongly based on TCF. The interests of the policyholders and the principles of TCF, were emphasised and insurers were required to have due regard to these. The balancing of competing interests of the stakeholders had to be undertaken with the ultimate outcome being the objective of the process. The fair outcome had to be demonstrated to the Authorities when a decision had been taken to vary the terms and conditions of the policy.

9.3 Concluding comments

The FSCA and PA by communicating their expectations as discussed above in the release of various joint communications, that insurers act responsibly in the interest of policyholders, and cautioning insurers to carefully consider any amendments which they were legally and contractually entitled to implement, encouraged insureds to challenge these decisions that were legally and economically sound. This view fails to take the position of re-insurers into consideration. Reinsurers bore the brunt of the costs of the court decisions. If these impose treaty conditions local insurers will have no alternative but to include these in their policies or not have reinsurance cover.

The FSCA and the PA in addition, did not encourage insurers to take cognisance of the fundamental principles underlying these business interruption policies. Insurers were required to provide justifiable reasons for either accepting liability or repudiating claims. The FSCA and the PA, advised that policyholders to not merely accept the position if an insurer denied coverage, and thereby actively encouraged policyholders to challenge such decisions. No communication was made regarding the challenges e.g. the uninsurability, of the business interruption losses which many insured businesses experienced, or the views of international reinsurers..

This created a ‘third force’ in the form of public opinion, which placed pressure on insurers to pay the claims, without adequate consideration of the fundamental principles of business interruption and consequential loss insurance.

10 FA NEWS PUBLICATIONS

Simultaneously with the research conducted for the dissertation, a series of articles has been written in the publication *FA News.* The series was co-authored by the author of this dissertation, Professor Vivian and Dawn Taylor. Reference has been made to these articles throughout the dissertation. The topics of the articles are as follows:

- Systematically set out the historical origin of the policy (*FA News* August 2021)
- Determine the fundamental principles to provide the cover (*FA News* October 2021*)*
- Set out the attempts to provide the cover (*FA News* November 2021*)*
- Capturing the cover in a policy (*FA News* February 2022)
- Policy wordings (*FA News* April 2022)
- Early cases dealing with consequential loss (*FA News* June 2022)
- The *Orient Express Hotels* case (*FA News* August 2022)
- Purpose and cover provided by extensions (*FA News* October 2022)
- Discussion of business interruption cases- SA cases and conclusive comments (*FA News* November 2022)

The publication of this series is important for the industry to provide clarity on the business interruption policy. The series has further been used for readers to gain CPD points as required. Attached as Annexure "I" are copies of the series. Annexure "J" is the final in the series published in the FA News in November 2022.

11 OVERVIEW AND CONCLUSIVE COMMENTS

In this dissertation, the consequential loss policy has been systematically analysed in order to be able to set out the underlying principles which underpin the policy. Having done this, the question of whether this policy is applicable to cover losses sustained for business interruption during the Covid-19 pandemic supported by a worldwide lockdown. The consequential loss policy is a policy which has been in existence for 120 years. Notwithstanding this, there is very little literature which deals with this policy and the literature that does exist, focuses primarily on the practical aspects of the policy, explaining accounting issues when dealing with consequential loss. There is no systematic analysis of the policy and as a result, along the way, the underlying principles of consequential loss have been either ignored or forgotten. These have been 'lost in translation'. The business interruption policy is complex and as a result, is not a well understood policy.

The absence of judicial interpretation directly caused by the paucity of litigation involving consequential loss policies, compounds the complexity and lack of understanding of the policy. The fundamental position can thus be summarised as follows:

(a) Historically insurance evolved to indemnify against loss or damage to property from specific perils. These are the property damage policies
(b) Property damage policies do not cover consequential losses or legal liability claims
(c) Separate policies evolved to augment the cover provided by property damage cover, covering revenue losses which arise when property is damaged
(d) This risk is insurable since the basic risk is the risk to independent property from independent events
(e) Extensions were added to the policy which could and did violate the above principles. The contagious disease policy is such an extension. It is susceptible to correlated events such as the world wide lockdown. It can be interpreted in such a way that is covers uninsurable events. This is what happened.

Therefore if the above principles are applied to the Covid-19 event the following conclusions can be reached:

(a) The American position is correct, business interruption claims against interruption policies arising out of Covid-19 are not insured (and insurable when supported by a

nation-wide lockdown). The American courts have correctly interpreted the policy in terms of the fundamental principles which underpin the policy.

(b) The outcome of the UK and SA court decisions imposed what is conceptually an uninsurable risk onto insurers:
    a. This can be attributed to the badly thought out and constructed contagious disease extension.
    b. The insurers have reacted as they have reacted in the past by clarifying the policy wording. In this case this was achieved via inserting a pandemic exclusion.
    c. The role of insurability did not receive adequate attention during the litigation either in South Africa or the UK.
    d. The pandemic exclusion would in any event be imposed on direct insurers by reinsures. The role of reinsurers should not be forgotten or underestimated.

(c) The contagious disease extension involved a non-material damage claim which falls outside of the historical scope of the consequential loss damage policy. This extension covers a pure financial loss. The BI policy is not well suited to deal with this kind of loss. It is recommended non-material loss cover is a different kind of cover and thus should be covered by a separate kind of policy. It should not be confused with the business interruption policy.

It is concluded, that the business interruption policy has not been well understood and as a result, the concept of insurability has also been overlooked. Business interruption loss, sustained as a result of Covid-19 is uninsurable. The additional challenges faced by the industry and the courts, is that the leading textbook did not adequately deal with the concepts underpinning the consequential loss policy.

What remains to be seen if business interruption loss caused by Covid-19 supported by a lockdown can be insured. If so, a new policy will have to be developed to cover these losses which on the present consequential loss policy, are uninsurable. By systematically setting out and explaining the policy, considerable clarification as to the operation of the policy will be achieved.

ANNEXURE "A" EARLY UK CASES

CITY TAILORS LTD V EVANS LLOYD'S LIST LAW REPORT 1921 CA 394

Facts

In *City Tailors, Ltd. v. Evans* (1921), the policy cover business interruption for a small clothing factory. The clothing manufactured was sold by retail outlets owned by the insured. The policy made provision for insured "profits" on a *per diem* basis. Payment was to be made for each day that the business could not manufacture due to fire damage at the specified factory premises at 226-228 Old Street . The gross insured profits included standing charges hence it was not only profits which were insured. The policy included a the usual clause which required that the insured do 'all things reasonably practicable to minimise any interruption … to avoid or diminish the loss.' (at page 395).

The meaning of insured "profits" as used in the policy was defined as meaning the net profit of the business added plus specified standing charges. Separate accounts were not maintained for the manufacturing operation.

The fire damaged the insured premises at Old Street which resulted in the total cessation of the manufacture of clothing at the damaged premises. The insured was able to lease alternative premises at the nearby Craven Street and continue with production from these alternative premises. The factory took a year to be rebuild. The insured claimed on the *per diem* policy for the entire year, notwithstanding the fact that it had leased alternative premises and continued its manufacturing operations. The insurer was a Lloyd's syndicate argued that the amount claimed as the loss ought to be reduced by taking into account the income generated at the alternative leased premises. The approach of the insurer was in line with the principle of indemnity. The insured based its argument on the basis that the policy was a valued policy and therefor any savings were immaterial to the amounts due in terms of the policy. The insurer further argued that in accordance with the prevention of loss clause, the insured had a legal obligation to mitigate and reduce the loss sustained and hence the income generated at the leased premises should be taken into consideration (Vivian & Mushai, 2020b- vol 1). The question that the court had to consider was thus whether the revenue that was generated from production at alternative business premises, should be accounted for in the calculation to determine the business interruption loss.

The three judges delivered separate judgements.

Decision

The court held that it could not account for the revenue which was generated from the production at the alternative premises, in the calculation to determine the business interruption loss. The rationale of the court was that the insured had no legal obligation to incur a further contractual obligation in order to reduce the consequential loss that was covered in the policy.

Discussion

It is evident from this decision, that the insured in terms of this policy, did not have a duty to mitigate loss. The insured had no obligation to mitigate its loss as the policy was structured in a way that it was a valued policy. A valued policy is one where the parties agreed on the value that will be paid in the event of a future loss. This assists the insured in the event of a loss, as the insured would not be required to prove its actual loss.

However, an insured's claim for indemnity may also be denied in the event that the inaction on the part of the insured itself was the proximate cause of the loss and which in itself, caused the chain of causation to be broken. Under the wording of updated business policies, this would not have been the decision of the court as in the ordinary course, the increased cost of working clause would cover this loss.

***HENRY BOOTH & SONS V THE COMMERCIAL UNION ASSURANCE CO LTD* (1923) 14 LLOYDS LR 114**

Background

The insured in this case was insured under a fire policy. The policy also include a business interruption section which also provided indemnification against loss and interference with business. The policy included indemnification for the wages of employees during the period after the fire. The policy provided for payment under two heads (A) and (B). A related to wages and (B) increase in cost of working. The policy provided that in the event of a loss a chartered accountant would certify the loss and that would be accepted as the quantum of the loss. A fire occurred and losses incurred under both headings. The insured's accountants duly certified the losses. A dispute arose between the parties and the matter was referred to an umpire who did not accepted the certified figures. The matter was placed before the court in

the form of a special case. The insured contended that "the certificate was the final determination of the amount of all loss. This contention was disputed by the insurer." The umpire took the view that since the policy set out the manner in which the loss had to be determined that that had to be applied.

Decision

Greer J took as the point of departure (114):

> 'It is common practice in policies of this sort, in order to prevent lengthy disputes, that there should be an agreed method of ascertaining the loss. Sometimes the assessment of the loss is in favour of the assurance company and sometimes the assured but it is nevertheless good sense to have a method which can be readily applied without difficulty and without raising a great number of points for dispute.…'

Thus without specifically declaring the policy to be a valued policy the court accepted this contention. What remained thus was the application of the facts to the term in the policy relating the determination of the amount payable which the court determined. The amounts payable differed from the certified amounts.

Discussion

The court applied the same approach which was applied in the *City Taylor Ltd* case. Business interruption policies are valued policies. The amount payable as indemnification is to be determined by the method set out in the policy itself. The court would not rely on the general principle of indemnity to arrive at the amount.

ANNEXURE "B" THE FCA TEST CASE

THE FINANCIAL CONDUCT AUTHORITY V ARCH INSURANCE (UK) LIMITED AND OTHERS **[2020] EWHC 2446 (COMM)**

AND

THE FINANCIAL CONDUCT AUTHORITY V ARCH INSURANCE (UK) LIMITED AND OTHERS **[2021] UKSC 1**

INTRODUCTION

The case aforesaid is commonly known as the "FCA test case" and is referred to as such in this dissertation. The case involved an analysis of numerous infectious disease extension wordings commonly used in the insurance market by several insurers as extensions to business interruption policies. It is vitally important to note that these cases as with the South African cases, dealt with the extensions to the policy and did not focus on the wording of the main policy. This was by no means a normal case. It was brought by the regulator the FCA in terms of specific legislation to obtain clarity with respect to Covid claims. In September 2020, the UK High Court found mostly in favor of policyholders. The usual procedure of proceeding to the Court of Appeal was not followed and the case was leapfrogged directly to the Supreme Court. Most of the decisions of the High Court was confirmed on appeal by the Supreme Court in January 2021 (Browning, 2021). The SC decision was even more favorable to insureds than the High Court decision.

HIGH COURT CASE 2020

Facts

As many insured businesses had been affected by the Covid-19 pandemic and had suffered significant business interruption losses, many businesses which had business interruption cover, submitted claims. The main BI policy requires direct property damage, with basic BI cover, which is sustained directly because of the physical property damage to sustain a claim. Some policies had infectious disease extension to the main policy. These are infectious or notifiable disease terms or extensions and non-damage denial of access and public authority closures of restrictions. Some insurers accepted their liability under the policies and other disputed such liability. This resulted in much uncertainty and lack of clarity which was the main reason why the FCA launched the test case.

The objective of the FCA when it lodged this test case, was to provide clarity on the key issues of which caused the uncertainty. The purpose of the case was to provide market certainty. A selection of representative sample of policy wordings from eight different insurers was obtained and used for the purpose of this case. The FCA acted on the part of policyholders and argued the case in their interest (FCA, 2020b). The purpose of the test case, was for the court to consider issues of principle in respect of policy coverage. The case concentrated in the question of causation, using a sample of policy wordings. 21 sample wordings were analysed. According to the FCA's estimate, some 700 types of policies, across 60 different insurers and approximately 370 00 policies had been accounted for and they produced a list of policies which might be affected by the judgement (FCA, 2020a).

The FCA test case was lodged by the Financial Conduct Authority, requesting the High Court to consider a range of different policy wordings. The Hiscox Action Group and Hospitality Insurance Group Action were permitted to intervene and made submissions and contributed to the case on behalf of policyholders. There were eight defendant insurers which had agreed to act as such in the test case. The following were the defendant parties:

- Arch Insurance (UK) Ltd
- Argenta Syndicate Management Ltd
- Ecclesiastical Insurance Office Plc
- MS Amlin Underwriting Ltd
- Hiscox Insurance Company Ltd
- QBE UK Ltd
- Royal and Sun Alliance Insurance Plc
- Zurich Insurance Plc

For the sake of completeness, a summary of the key events which occurred are listed below (Browning, 2021):

- On the 5 March 2020, in England and Wales, Covid-19 was declared a notifiable disease.

- On the 11 March 2020, the World Health Organisation declared Covid-19 to be a pandemic.
- On the 16 March 2020, the stay-at-home directive was made to the public by the UK Government and to stop non-essential contact and unnecessary travel, directing that the public must, if possible, work from home.
- On the 20 March 2020, various businesses were required to close.
- On the 23 March 2020, further lockdown measures were introduced.
- In the UK, the construction and manufacturing industries were not specifically directed to close, or specifically approved to remain operational.
- Directives were provided given guidelines on safer working environments i.e.. introducing social distances measures and sanitizing the workplace.
- There were widespread discussions considering whether force majeure clauses were effective in instances where there were delays in construction projects and would provide relief in terms of the monetary loss or time delays.

Decision

On the 15 September 2020, the High Court handed down its judgement, which found largely in favor of policyholders. It is important to note, that the decision does not mean that insurers are required to cover all types of losses or damages. The effect of this decision is that it was binding on specific sets of wording which had been considered. Although the decision seems simple, it is far from being simple and there are intricacies which must be carefully considered (Gurses, 2021). To properly assess whether cover is provided, the wording of each policy must be carefully assessed and evaluated against the background of the judgements. The applicability to each policy will only be clarified once this process is done, as the judgements will provide different insights to different policy wordings.

On the FCA website, in September 2020, the FCA (FCA, 2020) indicated that the legal impact of the test case will have different impacts.

> 'The result of the test case will be legally binding on the insurers that are parties to the test case in respect of the interpretation of the representative sample of policy wordings considered by the court. It will also provide persuasive guidance for the interpretation of similar policy wordings and claims, that can be taken into account in other court cases including in Scotland and Northern Ireland, by the Financial Ombudsman Service and by the FCA in looking at whether insurers are handling claims fairly……..

……Each policy needs to be considered against the detailed judgment to work out what it means for that policy. Policyholders with affected claims can expect to hear from their insurer within the next 7 days…….

The test case has removed the need for policyholders to resolve a number of the key issues individually with their insurers. It enabled them to benefit from the expert legal team assembled by the FCA, providing a comparatively quick and cost-effective solution to the legal uncertainty in the business interruption insurance market……..

……The test case is not intended to encompass all possible disputes, but to resolve some key contractual uncertainties and 'causation' issues to provide clarity for policyholders and insurers. It will not determine how much is payable under individual policies, but will provide the basis for doing so.'

The policy wordings by Zurich and Ecclesiastical Insurance contained terms which excluded these claims. Herbert Smith Freehills (Herbert Smith Freehills, 2020), who worked with the FCA on the case, summarized the impact of the case as follows:

'While different conclusions were reached in respect of each wording, the Court found in favor of the FCA on the majority of the key issues, in particular in respect of coverage triggers under most disease and 'hybrid' clauses, certain denial of access / public authority clauses, as well as causation and 'trends' clauses. The judgment should therefore bring welcome news for a significant number of the thousands of policyholders impacted by Covid-related business interruption losses.'

The key points which the court was required to focus on was how different policies had reacted to different situations. The factual background was common cause and there was no dispute on the circumstances resulting in the nationwide closures. The FCA test case focused on a few policies and the majority were irrelevant (Gurses, 2021). The FCA submitted that the proximate cause of the business interruption was the notifiable disease, and the individual outbreaks formed indivisible parts of it, with which submission the Court agreed. The alternative submission made was that each individual occurrences were separate, but effectively were the cause of the national actions (Herbert, Smith & Freehills, 2020). The following arguments were the focus of the court in this case and were considered as valid arguments:

1. 'Disease clauses': These are clauses which make provision for disease outbreaks in the vicinity (or not) of the affected / insured premises: These made provisions for cover for BI as a result of or arising out of the occurrence of a notifiable disease within a specific

radius of the insured premises. A notifiable disease is one which arises from any human infectious or contagious disease manifested in a human. They are of importance to public health because 'they pose significant public health risks that can result in disease outbreaks or epidemics with high case fatality rates both nationally and internationally' (Department of Health, 2017).

2. 'Denial or prevention of access clauses' based on a regulatory requirement or legal instruction to close down, made by public authorities: These provisions provided for the cover when there had been a prevention of access to denial to use the insured premises directly as a result of government action or public authorities' restrictions.

3. 'Hybrid clauses' being a combination of both types above: these refer to provisions where restrictions are imposed on the insured premises as a result of the occurrence of a notifiable disease.

'Trends clauses' were also considered. These are clauses which are included in BI policies which specify precisely if and how insurers should account for the likely effect on trading in the case when the business had not suffered the insured peril – but as in the case of the pandemic, had resulted in a reduction in the demand for the service or product. It is important to remember, that trends clauses are applicable where there is physical damage to the insured property.

The FCA presented argument to establish liability under the representative sample policy wording, and argued that the 'disease' and/or 'denial of access' clauses provide cover in circumstances like those of the Covid-19 pandemic. The trigger for the cover resulted in losses sustained by policyholders. The court was faced with three main challenges. The variation of wording between different operative clauses and whether these clauses could be read as a group or had to be considered separately. The second challenge, was the determination of the actual cause of the interruption. A direct causal link between the local occurrence of Covid-19 and the interruption of the business was required by some wordings (Gurses, 2021). The final challenge which had to be considered was the effect of the trends clause.

General Rules applicable to the construction of clauses

Before considering the policies and various clauses, the High Court explained that its approach would be to adhere to the general principles applicable to the interpretation of contracts. It would be required in accordance with those principles, to determine how a reasonable person, having the knowledge that would be reasonably available at the time of the contract, would have understood the terms and conditions of the policy. The assessment of the understanding would be objective, and no subjective interpretation would be permitted. In the case where the interpretations were inconsistent, the court would be required to follow the construction which was more aligned to and would make more business sense. The case of *Wood v Capita Insurance Services Ltd* was relied on for authority for this approach.

The High Court further referred to the *contra proferentum* rule, which states that in the event of ambiguity in a contract, the words will be construed against the person who drafted them. The rule would apply if there was uncertainty in the interpretation and if the ordinary rules of interpretation were not applicable. The High Court said when referring to the rule, 'if it still has any validity, can only apply if there is genuine ambiguity, which cannot otherwise be resolved by applying the principles of construction. It should not be relied on to create ambiguity where there is none.'

The Court referred to the following judgments in the discussion of the rule and its application. *Impact Funding Solutions Ltd (Respondent) v AIG Europe Insurance Ltd, Crowden v QBE Insurance (Europe) Ltd* and *Rainy Sky SA V Kookmin Bank* were referred to confirming the following key principles:

- If there was no ambiguity, there would be no purpose for the doctrine to be considered
- Before relying on the rule to assist with the interpretation of the wording, especially exclusions, the approach to be adopted must be one that accounts for the reason and purpose for the exclusion
- In the case of ambiguity, the approach of the court should be to take cognisance of the commercially sensible interpretation, and the rule should only be applied if the language was ambiguous
- The rule should be one that is only used as a last resort to assist in the interpretation should be occur that the first rules of interpretation cannot be applied (Dinnie, 2020a).

An example of a standard business interruption clause

A standard example of a business interruption clause which was subject to the litigation in this case is as follows:

> ‘We shall indemnify You in respect of interruption or interference with the Business during the Indemnity Period following:
>
> a) any
>
> i. occurrence of a Notifiable Disease (as defined below) at the Premises or attributable to food or drink supplied from the Premises;
>
> ii. discovery of an organism at the Premises likely to result in the occurrence of a Notifiable Disease;
>
> iii. occurrence of a Notifiable Disease within a radius of 25 miles of the Premises;
>
> b) the discovery of vermin or pests at the Premises which causes restrictions on the use of the Premises on the order or advice of the competent local authority;
>
> c) any accident causing defects in the drains or other sanitary arrangements at the Premises which causes restrictions on the use of the Premises on the order or advice of the competent local authority; or
>
> d) any occurrence of murder or suicide at the Premises.
>
> **Additional Definition in respect of Notifiable Diseases**
>
> 1. Notifiable Disease shall mean illness sustained by any person resulting from:
>
> i. food or drink poisoning; or ii. any human infectious or human contagious disease excluding Acquired Immune Deficiency Syndrome (AIDS) or an AIDS related condition an outbreak of which the competent local authority has stipulated shall be notified to them
>
> 2. For the purposes of this clause: Indemnity Period shall mean the period during which the results of the Business shall be affected in consequence of the occurrence discovery or accident beginning:
>
> i. in the case of a) and d) above with the date of the occurrence or discovery; or
>
> ii. in the case of b) and c) above the date from which the restrictions on the Premises applied; and ending not later than the Maximum Indemnity Period thereafter shown below. Premises shall mean only those locations stated in the Premises definition.
>
> In the event that the section includes an extension which deems loss destruction or Damage at other locations to be an Incident such extension shall not apply to this clause.
>
> 3. We shall not be liable under this clause for any costs incurred in the cleaning repair replacement recall or checking of Property
>
> 4. We shall only be liable for the loss arising at those Premises which are directly affected by the occurrence discovery or accident Maximum Indemnity Period shall mean 3 months’.

Insured risk

All the policies which were used in the sample, required the business operations to have been interrupted at the insured premises. Others included the provision that the occurrence had to occur within a specific radius or in the vicinity of the insured premises (Gurses, 2021). There is an important distinction between different triggers: the first based on the outbreak of an infectious disease which is a generalised event, not specifically experienced at the insured premises. The second trigger is the specific occurrence of the event at the insured premises or within a specific radius thereof. Both courts held that most of the policies had been triggered. But there were noticeable differences between the courts in their interpretation of the operative clauses. The High Court decided that in the second interruption, it had to be as a result of a local outbreak (Gurses, 2021). This position was not followed by the Supreme Court in the subsequent judgement.

Disease clauses

The RSA, Argenta, MS Amlin and QBE policy wordings fell into this category. The example of the wordings of these policies were:

> '…..interruption of or interference with the Business during the Indemnity Period following …….and occurrence of a Notifiable Disease within a radius of 25 miles of the Premises……'

Although slightly different, most wordings in this category provided cover for loss resulting from:

- interruption or interference with the business
- following / arising from / as a result of
- any notifiable disease / occurrence of a notifiable diseases / arising from any human infectious or human contagious disease manifested by any person
- within 25 miles / 1 mile / the "vicinity" of the premises / insured location

QBE had slightly different wording and provided cover for 'Loss resulting from interruption of interference with the business in consequence of any of the following events: … any occurrence of a notifiable disease within a radius of 25 miles" and "within a radius of one (1) mile of the premises'.

The argument proposed on behalf of the insurers was that this cover only covered a local occurrence of a notifiable disease, and within a specific radius. The argument was that if the disease was widespread, that these effects would not be covered. A distinction had to be made between a localised Covid-19 outbreak and the wider outbreak. They argued that 'but for' the local disease there would have been the same interruption or interference there could be no cover. In effect the insurers imported a 'but-for' causation requirement into the interpretation of these clauses. The counter-argument by the FCA, was based on the proximate cause. The proximate cause principle was satisfied on the basis that the Covid-19 outbreak in the area or vicinity of the insured premises was indivisible from the disease. The alternative argument was that there were many different effective causes as the disease has spread to a large number of places (Brown, 2020; Gurses, 2021).

The High Court upheld the argument made by the FCA, and agreed that the proximate cause of the business interruption was the notifiable disease. The point was accepted that the individual outbreaks of the disease, were indivisible parts of the notifiable disease. The alternative was that each individual outbreak although separate and individual occurrences, were as a group the effective cause of the Government and public actions to contain the outbreak (Gurses, 2021).

The following were key factors relied on by the High Court and as pointed out by Herbert Smith Freehills (2020) in reaching their decision:

- The occurrence of the disease was the actual outbreak of the disease. The important point in time and the trigger for these policies, is the point at which cases of the disease were diagnosed within the relevant area.
- The relevant policy area is where the cases were diagnosable – and it was immaterial whether the cases were actually being diagnosed or whether the symptoms of the disease were being identified;
- The composite peril of interruption or interference with the running of the business, following the existence of the notifiable disease within the defined radius of the insured property is the insured peril. The principle of proximate cause requires that the insured peril is directly caused and results in the loss for which a claim is made;
- The meaning of the word 'following' was considered although it was not material to the judgment. The word 'following' cannot be equated in meaning to the requirement

of a proximate case, which denotes a direct link, and 'following' implies a indirect link to the disease or a 'looser from of link';

- The provision of cover was not only provided in instances where the disease was limited to an area covered by the policy. The reason for this was a) the wording of the policy did not limit the outbreak of the disease within the defined area covered by the policy, but the notifiable disease was insured as the occurrence thereof was in the vicinity of the insured premises and b) this was the standard wording and interpretation of policy wordings which covered the occurrence of notifiable diseases. Notifiable disease by their nature, being complicated, fluid and highly contagious, are widely spread and as such demand a nation-wide response by local and national bodies. It is widely accepted that the cases of notifiable diseases within a defined insured area, cannot be separated from and considered independent of cases which exist outside of the insured area;
- One of the policies RSA4, included the word 'vicinity' and defined it as an:

> 'area surrounding or adjacent to an Insured Location in which events that occur within such area would be reasonably expected to have an impact on an Insured or the Insured's Business.'

The High Court interpreted this widely and admitted that whilst the normal interpretation of 'vicinity' would not ordinarily include the whole of England and Wales, that in respect of the interpretation relevant to Covid-19, an extensive area may well be regarded as the 'vicinity'. It further indicates the surrounds of the insured area as there is nothing to specifically define the size of the area being referred to.

For the most part, the judgement states that disease clauses which were considered, provided cover.

The Prevention of Access clauses

It was pointed out by the High Court, that there were a number of wordings in respect of BI cover, that required a prevention or hinderance or denial of access to the insured premises as a consequence of governmental or regulatory restrictions. In respect of the denial of access clauses, the determination whether cover was provided, would be dependent on the detailed wording of the specific clause and particularly, how the insured was affected by the Government response to the pandemic. Any mandatory order closing businesses completely would also be considered. The Court mostly considered the wording of policies written by

Arch, Ecclesiastical, Hiscox, MS Amlin, RSA and Zurich. The policies provided cover for losses which had been caused in the following situations:

- Prevention/ denial/ hinderance of access to the insured premises
- Due to actions / advice/ restrictions of/ imposed by order of
- A government/ local authority/ police / other body
- Due to an emergency likely to endanger life / neighbouring property / incident within a specified area

In determining the meaning of 'prevention' a distinction was made by the High Court between 'prevention' and 'hindrance'. 'Prevention' implies 'rendering impossible', 'hindering' means making 'something more or less difficult but not impossible' or 'imposing obstacles'. It was concluded by High Court that the prevention of access clauses had to be interpreted more restrictively than the disease clauses. They agreed with the insurers submissions that the restrictions imposed by government regulations, did not prevent access to premises which remained open. This would amount to a hinderance not prevention (Gurses, 2021).

In summary, the following key factors were considered by the Court in respect of these clauses (Herbert, Smith & Freehills, 2020; Gurses, 2021):

- The location and nature of the incident and the causal relationship between the location and the reaction of the authority to the incident: Wordings such as 'emergency within the vicinity', 'danger or disturbance in the vicinity', 'injury in the vicinity' and 'incident within 1 mile / the vicinity' were considered by the Court as describing a specific event occurring at a specific time and in a local area. The wording aforesaid in effect had the effect of narrowing down the cover to a specific area. Therefore, for cover to apply, the authority would be required to react to the localised occurrence of the disease. Accordingly, any action taken in response to a pandemic would not satisfy the requirements as specified in these wordings.
- The nature of the actions, advice, restrictions or order of the authority: The Court considered that the various announcements made by the Government during March 2020 and declared that they were considered as advice and distinguished them from mandatory orders. The definition of action would include advice as an action, which in this context amounted to a hindrance of the use of the insured premises. An action which

prevents access, implies that the action has legal enforcement with legal effects should the action not be followed. A restriction 'imposed by law' implies mandatory compliance which is distinguishable to advice given. Advice therefor would not trigger cover but mandatory instructions would trigger cover.

- The effect of the authority's action on access to the insured premises: The wording of some policies required that access to the premises had to be prevented or denied. The Court considered this as meaning that the premises had to be closed for the purposes of running the business, due to the action of the relevant authority.
- The effect on the business: The meaning of 'interruption' was considered by the Court and it was held that 'interruption' did not mean a total cessation of the business, but that this meant that the business was merely disruption and that its daily running was interfered with.

Whether this clause in a policy will provide cover, close consideration is required of the wording and the precise terms of the policy and the government advice or mandatory instruction given. The wording and the nature of the business would be relevant factors to consider whether the 'prevention of access' clause would be applicable and would trigger cover (Herbert, Smith & Freehills, 2020). The test case held that the Covid-19 pandemic and the Government and public response were a single cause or the covered loss. This is a key requirement for the consideration of claims and whether such claims will be paid.

The Hybrid Wordings

The Hybrid Clauses contained wording similar to the Disease Clauses, but had an element of the 'restrictions imposed on the premises' included in the wording. The wordings in the Hiscox and RSA policies fell within this category and were considered. The cover was provided for losses resulting from:

- An interruption of the business
- Due to an inability to use the premises
- Due to restrictions imposed by a public authority
- Following and occurrence of disease
- An outbreak of which must be notified to a local authority

As implied by the description of these clauses, they are a mixture of the disease wording clause and the prevention of access clauses. The argument presented by the insurers both to the 'disease clause' and to this 'hybrid clause', that cover would only be provided if the losses had resulted from a local outbreak, was rejected by the Court. The restrictive interpretation to the 'prevention of access clause' was applied by the High Court, and interpreted the various wordings to require a mandatory order having the force of law, especially in the context that the restrictions which were imposed, deprived insured's from the use of their premises. The 'inability to use' the insured premises was also interpreted to mean something more than just an impairment of normal use and a mere 'hinderance or disruption' of the normal use of the insured premises was not sufficient (Herbert, Smith & Freehills, 2020 ; Gurses, 2021).

The insurers argued that the meaning of the word 'interruption' meant a cessation or complete stopping of the business. The High Court did not agree with this interpretation and held that 'interruption' means business interruption, which includes disruption and interference, and not only complete cessation of the business (Gurses, 2021).

Trends Clauses

An issue which was critical in this case was the interpretation and application of the trends clause. The reason why it is so important is that insurers argued for the inclusion of components of the insured peril. By doing so, this would effectively negate the value of any cover available to the insured (Herbert, Smith & Freehills, 2020).

The purpose of a trends clause is a mechanism used to ensure that the insured is placed in the same position it would have been had the insured peril not occurred (Dinnie, 2020). To do so, a full assessment of the position the insured would have been in would have to be undertaken.

Insurers argued in favour of a narrow definition of the insured peril. The Court did not agreed with the argument, and in respect of the Hiscox wording, and were clearly unsympathetic to the argument presented by the insurers. By allowing for the application of the trends clause to the non-damage loss, the Court took the insured peril (i.e.. the business interruption loss caused by Covid-19) and the government response to it, out of the equation. The insurers argued that the principle of causation and the trends clause, resulted in no cover or indemnity being provided. The argument presented by the insurers, that even if there had

been a localised outbreak, the government action would still have occurred and the lockdown would have been imposed, was therefore rejected by the Court (Dinnie, 2020).

The following principles were provided by the Court as guidelines to the operation of trends clauses, aptly summarised by Herbert, Smith and Freehills (2020), in respect of each of the categories of the wordings above:

- 'Disease wordings: The insured peril is the interruption or interference with the Business following the occurrence of the disease including via the authorities' or public's response. The wordings in issue insured the effects of COVID-19 both within the specified radius and outside it, with the result that the whole of the disease both inside and outside the relevant area has to be stripped out in the counterfactual.
- Prevention of access / public authority wordings: the insured peril is a composite one involving three interconnected elements: (i) prevention or hindrance of access to or use of the premises; (ii) by any action of an authority; (iii) due to an emergency / incident which could endanger human life. All three must be stripped out of the counterfactual.
- Hybrid wordings: The insured peril is also a composite peril involving (i) inability to use the insured premises; (ii) due to restrictions imposed by a public authority; (iii) following the occurrence of a human infectious or contagious disease. Each of these interconnected elements should be removed from the counterfactual.'

Causation and the *Orient Express Hotel* case

The issue of causation was addressed by the Court in the *FCA v Arch Insurance (UK)* case, by interpreting each policy. In the majority of policies, the Court allowed cover for losses caused by a notifiable disease, although the losses were actually caused by the government action i.e.. the lockdown rather than the losses caused by the disease itself. As pointed out that the Court 'reduced the local occurrence requirement to a trigger, rather than a causative event' (Dinnie, 2020).

The Court considered the principle of causation and considered the circumstances where the word 'following' was used and what the causal connection required in those instances. In the wording of the RSA3 policy, the following words were used:

> 'We shall indemnify you in respect of interruption or interference with the Business during the Indemnity Period following …….. any……. occurrence of a Notifiable Disease within a radius of 25 miles of the Premises….'

It held that in these circumstances, causation was formulated as follows:

- The interference of the business or its interruption, should follow an occurrence of a notifiable disease which is distinguishable from the instance where the interruption or interference was 'proximately caused' by the notifiable disease;
- However, the loss sustained had to be 'proximately caused' by the interruption or interference of the business.

  The view taken by the Court was based on the meaning of the word 'following'.

Interpreting the word using its normal meaning, it denoted a causal link between the occurrence of the notifiable disease and the actual interruption of the business. This causative relationship was distinguished from the requirement of 'proximate cause', with the word 'following' being interpreted as referring to a less stringent causal relationship. The term 'proximate cause' was introduced by Section 55(1) of the Marine Insurance Act 1906, which states:

> '… the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against'.

The principle of 'proximate cause' was considered in House of Lords case *Leyland Shipping Ltd v Norwich Union Fire Insurance Society Limited* where the Court held that the 'proximate cause' 'is not the cause nearest in time to the loss but the 'efficient' or 'dominant cause' of the loss'. In this case, the ship was covered by an insurance policy which provided cover against the perils of the sea. It further included a warranty against all consequences of hostilities. Approximately 25 miles from port, the ship was torpedoed on a voyage to Le Havre, by a German submarine. Tugboats managed to assist and got the ship to port and was taken to a quay in the outer harbour. Whilst in port, during a gale storm, she bumped against the quay and the authorities, anticipating that she would block the quay, ordered the ship to moor at a berth inside the outer breakwater. For two days she survived gales and floods but on the third day, she sank, and was totally lost. The owners claimed for the loss of the ship on the basis that the loss was caused by the perils of the sea. The Court held that 'the grounding of the vessel was not a *novus casus interveniens* and that the torpedoing was the proximate cause of the loss.' The result being that the warranty against the consequences of hostilities protected the insurers. This is an example of an instance where the 'proximate cause' under the 1906 Marine Act was not always the event closest in time to the incident, but that one which efficiently was the cause of the incident.

The case of the *Orient Express Hotels Ltd v Assicurazioni Generali Spa,* was considered, and the correctness of the judgment was considered by the Court. The Defendants placed much reliance on the case of the *Orient Express Hotels Ltd v Assicurazioni Generali Spa,* particularly when arguing the submissions on causation and the trends clause. The High Court distinguished the cases, stating that 'nothing in the analysis in *Orient Express* had any impact on the correct construction of the wordings it was considering' (Herbert Smith Freehills, 2020; Gurses, 2021). The Court expressed their opinion that the *Orient Express Hotel* case was in such opinion, wrongly decided. The judge in the *Orient Express Hotel* case misidentified the correct insured peril. The Court expressed their view that the judge in the *Orient Express Hotel* case identified the damage to the hotel as the peril insured, when, in fact, the policy was an '*all-risks*' policy and the relevant peril should have included the hurricanes (Gurses, 2021). Accordingly, the Court ought not to have focused on the business interruption which was directly caused by the damage. The Court however, should have taken cognisance of the business interruption arising from the damage which was caused by the hurricane. The logical question then that ought to have been asked, was 'but for' the damage caused by the hurricane, would the hotel still have sustained the interruption of business. The High Court in the *Orient Express* case asked, 'but for' he damage, would the hotel still have sustained an interruption of its business (Herbert, Smith & Freehills, 2020 ; Gurses, 2021).

The aforesaid interpretation seems to be a matter of semantics, as it is unclear whether there is a difference and whether the Court would have reached a different decision. The test still links the losses suffered as a result of the business interruption to the damage caused, albeit the cause of the damage being the hurricane. In this case, the loss suffered by the hotel was caused by the occurrence of the hurricane, regardless of the damage it directly sustained.

The arguments presented by the Defendants, relied on the *Orient Express* case, and the Court in the FCA matter, took cognisance of these arguments, that the larger the extent of the damage caused, the less the amount of cover that would be provided. The argument in respect of the hotel being that if the hotel had only suffered damage caused by the hurricane, there would be no dispute on the cover for such damage. The corollary argument being that as the hurricane had damage the whole surrounding area, the cover for business interruption for the hotel would be refused. The Court held, that this could not have been the outcome that the parties had intended when providing for the cover for these occurrences. This is the basis upon which the Court in the case of the FCA case decided that the decision in the *Orient Express*

case was incorrect. The Court did go further and distinguished the *Orient Express* case to the present case, on the basis that the perils differed, and therefore it was not required to address the difficulties that the *Orient Express* case presented (Herbert, Smith & Freehills, 2020 ; Gurses, 2021).

The wording of the policy in the *Orient Express* case, created further complications. There was separate cover for Prevention of Access (POA) and Loss of Attraction (LOA). This additional 'extensions' clearly provide cover for business interruption loss caused by hurricanes, even if there was not physical damage sustained. The insured in the *Orient Express* case did not rely on this extension as there were limits of liability specifically limited the amount of cover provided for those occurrences. The policy included a 'trends clause' which effectively reduced the amount of cover it would have provided in respect of circumstances 'which would have affected the Business had the Damage not occurred……'.

RSA3 Wording and apparent conflict between an extension and exclusion

The wording of the RSA3 policy was specifically considered particularly in light of the apparent conflict of the wording in the main policy which covered any business interruption as a result of a notifiable disease. The policy seemed to also included the exclusion of losses or damage arising out of epidemics and diseases which was contained under the General Exclusion Clause. The extension to Section 2 was Extension vii 'Infectious Diseases'. The extension states as follows:

> 'We shall indemnify You in respect of interruption or interference with the Business during the Indemnity Period following:
>
> a) any
>
> i. occurrence of a Notifiable Disease (as defined below) at the Premises or attributable to food or drink supplied from the Premises;
>
> ii. discovery of an organism at the Premises likely to result in the occurrence of a Notifiable Disease;
>
> iii. occurrence of a Notifiable Disease within a radius of 25 miles of the Premises;
>
> b)the discovery of vermin or pests at the Premises which causes restrictions on the use of the Premises on the order or advice of the competent local authority;

c) any accident causing defects in the drains or other sanitary arrangements at the Premises which causes restrictions on the use of the Premises on the order or advice of the competent local authority; or

d) any occurrence of murder or suicide at the Premises.'

RSA argued that cover for the effects of an epidemic such as Covid-19 was excluded by the General Exclusion L. The provisions of General Exclusion L are as follows:

'Applicable to all sections other than section 5 - Employers' Liability and section 6 - Public Liability Contamination or Pollution Clause

a) **The insurance by this Policy does not cover any loss or Damage due to** contamination pollution soot deposition impairment with dust chemical precipitation adulteration poisoning impurity **epidemic and disease** or due to any limitation or prevention of the use of objects because of hazards to health.

b) This exclusion does not apply if such loss or Damage arises out of one or more of the following Perils:

- Fire, Lightning, Explosion, Impact of Aircraft
- Vehicle Impact Sonic Boom
- Accidental Escape of Water from any tank apparatus or pipe Riot, Civil Commotion, Malicious Damage
- Storm, Hail Flood Inundation Earthquake
- Landslide Subsidence Pressure of Snow, Avalanche Volcanic Eruption

a)(bis) If a Peril not excluded from this Policy arises directly from Pollution and/or Contamination any loss or Damage arising directly from that Peril shall be covered.

b)(bis)All other terms and conditions of this Policy shall be unaltered and especially the exclusions shall not be superseded by this clause.'

The High Court considered the aforesaid conflict and held that the General Exclusion L should be interpreted so as not to restrict the cover specifically included in the aforesaid extension. It stated at paragraph 115:

'Indeed, in the "Additional Definition in respect of Notifiable Diseases" within Extension vii, Notifiable Disease is defined to include an illness sustained by any person resulting from "food or drink poisoning". Similarly, General Exclusion L seems to exclude "loss or Damage" due to "disease". This is notwithstanding that Extension vii quite clearly provides express cover for business interruption following Notifiable Diseases. We have no doubt that a reasonable person would not understand the insurance to be expressly giving cover with one hand and taking it away by the other in the form of the list of matters referred to in General Exclusion L'.

Discussion

The FCA deemed it a matter of concern that insurers were repudiating the claims which had been submitted, which impacted on companies by prolonging their financial hardship which they had experienced during lockdown. In addition, in the event that claims were accepted, the challenges facing the insureds was computation of their losses and proving these losses. The FCA believed that it was in the public interest to launch the application to get certainty about the issues aforesaid. The decision of the High Court was welcomed by policyholders, particularly those who had policies which included the Disease and Hybrid clauses. The policies with Prevention of Access clauses, also provided relief depending on the wordings.

After this judgment, the insureds carefully considered their wordings to determine whether they would be covered and further, what steps they had to take to prove their claims. The relief was short-lived, as the insurers immediately thereafter, filed an appeal against the decision of the High Court. Subsequently, most insurers have reviewed their wordings to ensure that there is clarity of what insured events are indemnified.

THE 2021 SUPREME COURT - COURT CASE

Facts

The SC accepted the facts as set out in the High Court judgment.

Decision

The decision of the High Court was then taken on appeal by six insurers and the Hiscox Action group. The appeal was leapfrogged directly to the Supreme Court. It was heard in November 2020 and the judgement was handed down on the 15 January 2021. Generally, the Supreme Court found in favour of the FCA and the policyholders and unanimously dismissed the insurers appeals. Four of the points of appeals made by the FCA were upheld, two of which were qualified. There were differences of approaches between the conclusions of the High and Supreme Court. However, the judgements were similar with the Supreme Court judgement finding that more of the relevant policies might provide cover. The Supreme Court found that both ‘disease clauses’ and ‘denial of access clauses’ responded to the same underlying case being Covid-19. It further held that certain businesses which were partially closed, should also be covered for losses incurred as a result of these closures. Herbert Smith Freehills (2021) (Brown, 2021), in response to a question as to what this judgement means for policyholders, responded as follows:

> 'The judgment brings very good news for policyholders. It improves their position significantly beyond that which was already established by the High Court judgment. Although the Supreme Court construed the disease clauses more narrowly than the High Court, it gave broader interpretations to key coverage words in the prevention of access / hybrid wordings (especially as to partial closure of a business) and, most significantly, its findings on causation mean that it will be very challenging for insurers to deny cover, or reduce an indemnity otherwise due to an insured, on the basis that losses that would otherwise be covered under the policy would have resulted in any event from uninsured perils whose underlying cause is the Covid-19 pandemic. This will have significant implications in real terms for the indemnities received by policyholders.'

The parties appealed numerous issues, and for clarity, the Supreme Court 13020 emphasised the issues as follows:

- The interpretation of the disease clauses;
- The interpretation of the prevention of access and hybrid clauses;
- Causation;
- The trends clauses;
- Pre-trigger losses, and
- The *Orient Express Hotel* decision.

Disease clauses

Argenta, MS Amlin, QBE and RSA appealed the decision of the High Court as their policies contained examples of these clauses. The appeal was made on the proper construction of the wording of these policies. The FCA appealed the decision on the proper construction of the QBE disease clauses. Notwithstanding the variations of the wordings of these clauses, the Supreme Court ultimately held that these differences did not materially change the interpretation of the clauses.

The Supreme Court considered the meaning of the words of a typical insuring clause as included in the RSA3 policy: '…..any …….occurrence of a Notifiable Disease within a radius of 25 miles of the Premises.' 'Notifiable Disease' was defined as an 'illness sustained by any person resulting from ……..any human infections or human contagious disease…….an outbreak of which the competent local authority has stipulated shall be notified to them.'

Insurers argued that the clause only covered consequences of business interruption in the event that the notifiable disease occurred within the 25-mile radius of the insured premises. This interpretation would in effect have limited the extent of cover provided by the insurers, as it would be difficult or impossible for an insured to prove that the disease was localized and

existed within the 25-mile radius of the insured premises. The FCA counter-argued that the clause provided cover for business interruption of a notifiable disease, wherever that disease occurred, with the proviso that it occurred within the 25 miles radius.

The High Court and the Supreme Court differed in their interpretation of this clause. The conclusion on the application of this clause was the same in both decisions, albeit that the Supreme Court made different findings on the issue of causation. It held that the clause did not include a requirement that cover was only provided for an occurrence, some part of which is within the 25-mile radius, but that there is cover for 'any ……occurrence of a Notifiable Disease within the radius of 25 miles of the Premises.' Therefor only an occurrence within the 25-mile radius is an insured peril and anything else that occurs outside of that radius, is not considered as an insured peril. In addition, every individual case of illness is considered as an occurrence, and 'Notifiable Disease' as it is used is not the outbreak nor the disease itself, but rather the illness sustained by any person caused by the disease. The Supreme Court therefore held that the disease clause provided cover for business interruption losses caused by any cases of the disease resulting from Covid-19, which occurred within the 25-mile radius of the insured premises, and not for occurrences outside of that radius (*FCA v Arch Insurance and others* [2021] at para 72-74).

Both courts agreed about the scope of cover available to policyholders. Both the High Court and the Supreme Court agreed on the following: firstly, that the language of the disease clause did not limit cover to business interruption which results only from cases of a notifiable disease within the 25-mile radius, as opposed to other cases elsewhere, and, secondly, that in interpreting the policy wording it was important to take notice of the potential of the notifiable disease to affect a wider area. It is important to note that neither point above support the conclusion that cases of the notifiable disease occurring outside of the 25-mile radius, do fall part of the insured peril, these points were important in the consideration by the Supreme Court of the issue of causation (Herbert, Smith & Freehills, 2021).

With regard to the apparent conflict of the RSA3 wording between the extension and exclusion, the Supreme Court agreed with the approach of the High Court and agreed that General Exclusion L does not exclude claims arising out of the COVID-19 epidemic, stating the following:

> 'The notion that such a policyholder who is presumed to have reached p 93 of the RSA 3 policy wording would understand the general exclusion of contamination or pollution and kindred risks on that page to be removing a substantial part of the cover for business interruption loss that was ostensibly conferred on p 38 is as unreasonable as it is unrealistic.

> The reasonable reader would naturally assume that, if the intention had been to put a further substantive limit on the risk of business interruption specifically insured by the extension for infectious diseases in addition to the geographical and temporal limits stated in the extension itself, this would have been done transparently as part of the wording of the extension and not buried away in the middle of a general exclusion of contamination and pollution risks at the back of the policy. The reference in the exclusion to "disease" would reinforce the understanding that the general exclusion could not have been intended to apply to the cover for business interruption caused by an infectious disease, as it would obliterate that cover. It could not sensibly be thought to make a difference that the word "disease" was part of a composite phrase "disease and epidemic". No reasonable reader would suppose that, although one part of this phrase was not intended to apply to the business interruption cover, the other part was' (paragraph 78).

The variations between the different wordings of various disease clauses were considered, and the Supreme Court reached the same conclusion as it did in the RSA3 policy. The following points must be noted as emphasized by Herbert, Smith and Freehills (2021):

- The word 'occurrence' was not included in the MSA wordings. The definition of 'notifiable disease' was consistent throughout the various policies, and it was clear that the insured peril was not the disease itself, but individual cases of 'illness sustained by any person resulting from' the relevant disease.

- In respect of the QBE policy, and the wording of the disease clause therein, the subject was a disease and not an occurrence of the 'illness sustained by any person resulting from' the relevant disease. Regardless of this difference, the Court held that the insured peril was the occurrence of the disease was manifested by any person whilst present at the insured premises or within a 25-mile radius of the insured premises.

- In the other two QBE policies, the disease clause in those policies covered:

  > 'loss resulting from interruption of or interference with the business in consequence of any of the following events… any occurrence of a notifiable disease within a radius of 25 miles of the premises;… provided that the… insurer shall only be liable for loss arising at those premises which are directly subject to the incident'

  In paragraph 93 of the judgement, the Court considered and concluded the following:

  > 'We agree with these observations but cannot accept that the terms "event" and "incident" are necessary to make it clear that what is covered by the clause is any occurrence(s) of a

> notifiable disease within the 25 miles. That is already plain from the description of the insured peril as "any occurrence of a notifiable disease within a radius of 25 miles of the premises". We do not perceive any difference in meaning between the terms "occurrence" and "event", and nothing significant is added by the use of the word "incident" as a compendious term instead of the phrase "occurrence discovery or accident" used, for example, in the definition of the indemnity period in RSA 3. Furthermore, the other matters referred to in (a), (b) and (d) to (f) in clause 3.2.4 of QBE 2 are exactly the same as those referred to in the corresponding sub-clauses in RSA 3, and the nature of those matters confirms equally in both cases that the clause is concerned with the consequences of particular events occurring at a particular time and place. Yet further, the definition of a "notifiable disease" in QBE 2 is identical to the definition of that term in RSA 3 and, as discussed earlier, makes it clear that it is not the disease itself but particular cases of illness sustained by a person resulting from a relevant disease which constitutes the insured peril.'

The Supreme Court placed a more restrictive interpretation to the disease clauses than the interpretation of the High Court (*FCA v Arch Insurance,* 2021 paragraph 95). However, this in practice did not affect the cover provided by the disease clauses, because of the approach it had to the issue of causation, that all individual cases were equal to proximate causes (Herbert, Smith & Freehills, 2021).

The Prevention of Access and Hybrid clauses

The approach of the Supreme Court to the disease portion of the hybrid clauses, was wider than that of the High Court. The Supreme Court had to consider the following issues which were raised on appeal:

- The nature of the public authority intervention to trigger the clause, specifically whether the intervention of the public authority had to have the force of law (*FCA v Arch Insurance* paragraph 112 to 128). Succinctly summarised by Herbert, Smith & Freehills (2021):

> 'The meanings of the following words were considered: "restrictions imposed", "closure or restrictions placed", "enforced closure", "action" preventing access, and a denial or hindrance in access "imposed". The High Court had held that the only relevant matters which constituted "restrictions imposed" are those which were promulgated by statutory instrument, e.g. the 21 and 26 March Regulations. Instructions given by the UK Government which did not have the force of law would not satisfy the description. The point is a significant one – the FCA and the Hiscox Interveners wished to establish that cover was triggered by Government intervention (such as the Prime Minister's instructions in his early national broadcasts to 'stay at home' and that certain businesses should close)

before the 21 March and 26 March Regulations were issued so that losses sustained before those dates were capable of being recovered under the insurance.'

- The nature of the prevention or the hinderance of access / use required to trigger the clause (*FCA v Arch Insurance* paragraph 129-159). In these paragraphs the Court considered the meanings of the following phrases: 'inability to use', 'prevention of access' and 'interruption.' The clauses relevant to non-damage Public Authority did not all cover business interruption due to 'restrictions imposed' by a public authority following a notifiable disease. These clauses applied in instances where an insured was unable to use the insured premises because of restrictions imposed. The Supreme Court agreed with the High Court on the distinction between an 'inability to use' and a 'hindrance' or a 'disruption' to normal use. The 'inability to use' meant that there was a complete inability to use the insured premises. Anything less than a total 'inability to use' did not amount to 'prevention of access' (Dinnie, 2021). The policy wordings generally required the losses to result from 'an interruption of your activities……' This meant business interruption needed to be stopped or there needed to be a break in business operations in order to satisfy the definition of 'interruption.' A reduction in business was interpreted as a 'hinderance'. The Supreme Court held that an 'interruption' could include an 'interference' or 'hinderance' without resulting in a complete cessation of operation of the business. Even if slight, it would be covered only if there was a material effect on the financial performance of the business (Dinnie, 2021b). As pointed out, this approach of the Supreme Court was important for the interpretation of hybrid clauses, as it increased the scope of these wordings. Many were prevented from receiving cover in cases where they were restricted from operating only portions of their businesses e.g. Restaurants with both sit-down and takeaway business, were forced only to close the sit-down part of the business yet could continue to operate its takeaway business (Herbert, Smith & Fairhills, 2021).

- The Supreme Court rejected the High Court's interpretation of 'restrictions imposed' which required mandatory terms with legal enforcement, which was distinguished from mere 'instructions', which were not mandatory and voluntary in nature. The Supreme Court disagreed with this interpretation and stated that 'instructions' which were given by a public authority could amount to a 'restriction imposed', if it had the force of legal enforcement which would compel compliance. An instruction in mandatory terms,

giving the reasonable impression that it had to be complied with, regardless of whether it could be legally enforceable, would be considered as a 'restriction imposed' (Reed Smith, 2021).

- The increased cost of working was included in some policies which envisaged a partial interruption of business. The various heads of cover covering perils which caused 'interruption to your activities' clearly intended providing cover for instances where there 'was limited interruption and not a cessation of activities' (Dinnie, 2021b ; *FCA v Arch Insurance* 2021 at paragraph 158.)

Causation

The Supreme Court, contrary the approach of the High Court, considering the correct interpretation of the disease clause, placed emphasis on and highlighted the importance of questions of causation. They concluded that the disease clauses covered only the effects of cases of Covid-19 which occurred within the specific radius as defined of the insured premises. The court then considered he question of 'what connection must be shown between any such cases of disease and the business interruption loss for which an insurance claim is made becomes critical' (*FCA v Arch Insurance,* 2021 at paragraph 161).

Insurers argued that in order to satisfy the requirements of causation, an insured was required to prove that the loss would not have been sustained 'but for' the occurrence of the insured peril. The submission made by the insurers, was that because of the widespread nature of the pandemic, policyholders would suffer 'the same or similar business interruption losses, even if the insured peril (whether it be occurrence of the disease within the radius, or the public authority action causing a prevention of access) had not occurred, and as such the policies did not respond' (Herbert, Smith & Freehills, 2021). The Supreme Court rejected the insurers argument of the 'but for' test proving causation and stated that 'the most conspicuous weakness of the 'but for' test is not that it wrongly excludes cases in which there is a causal link, but that it fails to exclude a great many cases in which X would not be regarded as an effective or proximate cause of Y'.

The causal connection required to satisfy the requirements of causation, had to account of the nature of the cover provided. This may be satisfied 'where the insured peril, in combination with many other similar uninsured events, brings about a loss with a sufficient

degree of inevitability, even if the occurrence of the insured peril is neither necessary not sufficient to bring about the loss by itself' (Herbert, Smith & Freehills, 2021). Having consideration of the Supreme Court's approach to the interpretation of these clauses, these clauses would respond in instances where there was not only a localised occurrence of the disease within a wider pandemic, but also in cases where the localised occurrence would not be adequate to cause the losses sustained by the policyholders (Herbert, Smith & Freehills, 2021).

The Court considered the issue of causation depth, and considered the various tests, starting with proximate causation and the 'but for' test. The insurers based their argument on the 'but for' test (Reed Smith, 2021), which was dismissed by the Court stating at paragraph 182:

> 'It has, however, long been recognised that in law as indeed in other areas of life the "but for" test is inadequate, not only because it is over-inclusive, but also because it excludes some cases where one event could or would be regarded as a cause of another event'.

The Supreme Court followed the considerations of proximate cause of the High Court. The law applicable to proximate cause as codified in section 55(1) of the Marine Insurance Act 1906, was considered. It was reiterated that the generally accepted approach is that the causal link between the insured peril and loss is one of proximate cause, based on the presumption that this was the intention of the parties. 'But it is a presumption capable of being displaced if, on its proper interpretation, the policy provides for some other connection between loss and the occurrence of an insured peril' (*FCA v Arch Insurance,* 2021 at paragraph 163). The reason for this given by the Supreme Court, is that although an interpretation of the policy will provide clarity on whether loss has been caused by an insured peril or not, unlike the interpretation of the disease, hybrid and prevention of access clauses, it is not dependant on how the words used would be understood by the ordinary man in the street. 'The relevant is the legal effect of the insurance contract, as applied to a particular factual situation' (Herbert, Smith & Freehills, 2021).

The Supreme Court considered the cases of *JJ Lloyd Instruments ltd v Northern Star Insurance Co Ltd (The Miss Jay Jay),* and *Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corporation Ltd* cases. In cases where two proximate cause of loss have been identified, neither of which is excluded, but only one is insured, in the *Miss Jay Jay* case, it was held that insurers would be held liable for the loss. The case of *Wayne Tank and Pump Co*

Ltd v Employers Liability Assurance Corporation Ltd, held that in instances where there are two proximate causes of the loss, one being an insured peril and the other being excluded, the exclusion will generally be upheld, subject to the rules of interpretation. The approach of the Supreme Court at paragraph 176, was as follows:

> 'There is, in our view, no reason in principle why such an analysis cannot be applied to multiple causes which act in combination to bring about a loss. Thus, in the present case it obviously could not be said that any individual case of illness resulting from COVID-19, on its own, caused the UK Government to introduce restrictions which led directly to business interruption. However, as the court below found, the Government measures were taken in response to information about all the cases of COVID-19 in the country as a whole. We agree with the court below that it is realistic to analyse this situation as one in which "all the cases were equal causes of the imposition of national measures" (para 112)'.

The important point of this approach, is that the Supreme Court identified the trigger – namely in the case of the disease clauses, an individual case of Covid-19 in the area specified in the policy (Herbert, Smith & Freehills, 2021; Reed Smith, 2021). In conclusion of the issue of causation, the Court stated that in principle, there was nothing precluding an insured peril which, in combination of similar uninsured events, together resulting in loss which inevitably can be regarded as a cause- a proximate one- of the loss. This would hold true even in the event of the occurrence of the insured peril being unable to cause the loss itself . It was acknowledged by the Court, that the assessment of the issue of causation becomes more complicated with the increased number of separate events combining to cause the loss. Ultimately, the policy wording must direct and determine the risks which the insurers have contractually promised to cover. The interpretation of the contract is imperative in this determination of liability of the insurer (Herbert, Smith & Freehills, 2021).

The causal link in the disease clauses

The Supreme Court agreed with the conclusion of the High Court and held that (at paragraph 194):

> '……..no reasonable person would suppose that, if an outbreak of an infectious disease occurred which included cases within such a radius and was sufficiently serious to interrupt the policyholder's business, all the cases of disease would necessarily occur within the radius. It is highly likely that such an outbreak would comprise cases both inside and outside the radius and that measures taken by a public authority which affected the business would be taken in response to the outbreak as a whole and not just to those cases of disease which happened to fall within the circumference of the circle described by the radius provision.'

The Supreme Court concluded that, in order to properly interpret the disease clauses, and to prove that the loss suffered by the insured from the interruption of the business was proximately caused by one or more occurrences of Covid-19, it was sufficient to prove that it was Government intervention, in response to identified cases of the disease , which included one case within the specified geographical area. The conclusion aforesaid was based on the legal effect of insurance contracts as they applied to the facts of each case, and did not depend on the particular terminology used i.e.. 'following', 'arising from' or 'as a result of' (Herbert, Smith & Freehills, 2021).

The causal link in the prevention of access and hybrid clauses

In respect of the issue of causation, in the prevention of access and hybrid clauses, the Supreme Court differed in its decision with that of the High Court. The effect of the decision of the Supreme Court, is that it makes cover more readily available under these clauses (Reed Smith, 2021). The 'peril' covered by these wordings consist of 'a series of elements that are required to occur in a sequence in order to give rise to a right of indemnity' (Reed Smith 2021). The important points are as follows: (i) legislation ordering closure is not required (ii) it is not necessary to prove complete 'inability to use' the insured premises, and partial 'inability to use' will suffice. The elements aforesaid must all be satisfied and a causal connection to the loss must be identified (Reed Smith, 2021).

The argument presented on behalf of the insurers, based on the 'but for' test, was rejected by the Court. This has been analysed above. The Supreme Court concluded that these clauses provided indemnity against the risk of all the elements of the insured peril, which together combined to cause business interruption loss. This occurred regardless of whether the loss was caused concurrently by other (uninsured but not excluded) consequences of the Covid-19 pandemic, either an underlying or originating cause of the insured peril (Herbert, Smith, Freehills, 2021).

Trends Clauses

All the insurers who appealed against the decision of the High Court, appealed on the basis of the application of the trends clauses in the circumstances of the case. They contended that these clauses in effect do not provide indemnity for losses sustained by policyholders, as the losses would have occurred regardless of the operation of the insured perils arising as consequences of Covid-19 pandemic (paragraph 251).

An example of a trends clause in the Hiscox 3 wording which was subject to consideration by both courts is set out below:

> 'Business trends
>
> The amount we pay for loss of gross profit will be amended to reflect any special circumstances or business trends affecting your business, either before or after the loss, in order that the amount paid reflects as near as possible, the result that would have been achieved if the damage had not occurred.'

There were various wordings of the trends clause across the various policies. The Supreme Court disagreed with the submissions made by the insurers, regarding the trends clauses and held the following key principles in its analysis of the trends clauses(paragraph 260 -262):

- Trends clauses are included in policies with the purpose of providing a mechanism to quantify the loss, and not for the purpose of delineating the scope of the indemnity. The insuring clauses in a policy serve the purpose of defining the scope of the indemnity.
- Trends clauses should, as far as possible, be construed consistently with the insuring clause of the policy.
- Trends clauses then should not diminish the cover provided in the insuring clause. If this occurred, then the 'quantification machinery' of the policy, would be transformed into an exclusion.

In conclusion, at paragraph 287, the Supreme Court stated the following in respect of the trends clause and it application:

> 'For the reasons given, we consider that the trends clauses in issue on these appeals should be construed so that the standard turnover or gross profit derived from previous trading is adjusted only to reflect circumstances which are unconnected with the insured peril and not circumstances which are inextricably linked with the insured peril in the sense that they have the same underlying or originating cause. Such an approach ensures that the trends clause is construed consistently with the insuring clause, and not so as to take away cover prima facie provided by that clause.'

In summary, this significant decision regarding trends clause impacts on the interests of policyholders. In the absent of clear wording, indemnity cannot be reduced on the basis that the losses were equally caused by other perils, the underlying cause of which was also the Covid-19 pandemic (Herbert, Smith & Fairhills, 2021; Gurses, 2021).

Pre-trigger losses

Another issue which arose as a result of the interpretation of the trends clauses, is the issue of pre-trigger losses. The High Court allowed for adjustments made in accordance with the provisions of the trends clause, which included an allowance for the downturn of a business due to Covid-19 before the insured peril was triggered. This approach was not followed by the Supreme Court which held the following (at paragraph 296):

> 'Accordingly, we consider that the court below was wrong to hold that the indemnity for business interruption loss sustained after cover was triggered should be reduced to reflect a downturn in the turnover of the business due to COVID-19 which would have continued even if cover had not been triggered by the insured peril. The court had correctly concluded that losses should be assessed on the assumption that there was no COVID-19 pandemic. Consistently with that conclusion, the court should have held that, in calculating loss, the assumption should be made that pre-trigger losses caused by the pandemic would not have continued during the operation of the insured peril'.

The *Orient Express Hotels* decision

The decision of the court in the case of *Orient Express Hotels,* presented challenges for the courts in this matter. The Supreme Court found that the incorrect decision was reached, both at the arbitral tribunal and at court, and stated that these entities have erred in those proceedings, in their interpretation of the application of the trends clause. The court found that errors were made in that they failed to exclude circumstances which had the same underlying cause as the damage, from the assessment thereof. To reach the decisions in the present matter, Lord Hamblin and Lord Leggatt had to overrule their previous decision. The following was said by them regarding this change of opinion:

> 'For reasons already given in addressing the causation and trends clauses issues, a mature and considered reflection we also consider that it was wrongly decided and conclude that it should be overruled.

Discussion

The important point to be noted from the Supreme Court case, is that the approach of the court in the *Orient Express Hotels* case is according to the Supreme Court, incorrect. The SCA decision further refused to link the business interruption to locality in its analysis of the different clauses (Gurses, 2021). The implications of this for business interruption cover in natural disaster and other physical damage cases, is clear, particularly with regard to the interpretation of the trends clauses. Parties should review these clauses particularly with this

decision in mind (Herbert, Smith & Freehills, 2021). The ‘but for’ test has been determined that in certain circumstances, it will not be applicable in addressing questions relating to the proximate cause. In instances where its application would result in the narrowing of cover, or removal thereof, the rational is that this could not have been the intention of the parties, and accordingly, would not be applied (Herbert, Smith &Freehills, 2021). As pointed out (Herbert, Smith & Freehills, 2021), that ‘certain elements of a composite insured peril should not diminish the scope of the indemnity due to an insured if they arise from the same original fortuity which the parties to the insurance would expect to occur concurrently with the insured peril’. Uninsured perils should also not affect the scope of cover, where they arise from the same event from which the insured peril arose. The court emphasised that the wording of the policy must be focused on and the construction of the policy must provide guidance on how to interpret and determine the indemnity which the policy provides. The implications of this case are wide and impact the insurance industry generally, particularly in respect of trends clauses and causation.

ANNEXURE "C" *ORIENT EXPRESS HOTELS CASE*

ORIENT EXPRESS HOTELS LTD V ASSICURAZIONI GENERALI SPA

[2010] EWHC 1186 (Comm)

Facts

The case was an appeal taken in terms of s69 of the Arbitration Act 1996, against an arbitration award made by an arbitration tribunal. It is important to note it was not an appeal from a lower court. The process thus did not follow the normal trial process and the powers of the court dealing with an appeal from an arbitration process different. As a general rule the court will only overturn the decision of the tribunal if it makes an error of law. The arbitration was published in November 2009. The tribunal consisted of Sir Gordon Langley (Chairman), Mr. George Leggatt QC and Mr. John O'Neill FCII ("the Tribunal"). The appeal was pursuant on permission given by Mr. Justice Burton.

The arbitration considered the effects Hurricane Katrina and Hurricane Rita in New Orleans in the autumn of 2005. Wind and water caused significant damage to the hotel resulting it its closure from September to the end of October 2005. It reopened in November 2005; although it was not yet fully repaired which impacted on its services and amenities, which were not fully operational. OEH suffered significant losses as a result of the business not being operational for a period and then not fully operational (para 4). OEH acknowledged that it was required to prove that it sustained physical damage, and that it could only recover business interruption losses which resulted from the physical damage to the hotel (pars 6).

The insurer repudiated the claim for business interruption on the grounds that, with or without physical damage, the business interruption loss would have been the same since the surrounding area had been closed off and no-one would have come to the hotel. It is clear that for the month of September 2005 New Orleans was under curfew – lockdown (par 8).

OEH contended if the hotel was damaged by the insured peril, the hurricane, it was entitled to indemnification for the consequential losses even the cause of this loss could only be ascribed to the concurrent impact of the hurricane in a broader sense (par 9). The insurer on the other hand contended its obligation to indemnification does not arise but for the damage to the hotel (par 10). The damage to the hotel itself had to be the cause of the loss. The

arbitration tribunal agreed with the insurer. An undamaged hotel in the position of the OEH would have suffered the same interruption loss (10).

OEH argued the tribunal made an error in law and appealed to the High Court. The appeal focused on two questions of law which arose from combined policy with property damage section and a business interruption section. The two questions were as follows (par 2):

(1) Whether on a consideration of the construction of the Policy, whether it provided cover in respect of loss which was caused concurrently by: (i) physical damage to the property; and (ii) damage to or consequent loss of attraction of the surrounding area; and

(2) Whether on the true construction of the Policy, the same event(s) which cause the damage to the insured property which gives rise to the business interruption loss are also capable of being or giving rise to 'special circumstances' for the purposes of allowing an adjustment of the same business interruption loss within the scope of the 'Trends Clause'.

The principal clauses of the policy were as follows:

(1) The Policy's Insuring Clause:

'In consideration of the Insured... paying the premium.... the Insurers... agree... to indemnify the Insured

a) under the Material Damage and Machinery Breakdown Sections against direct physical loss destruction or damage except as excluded here into Property as defined herein such loss destruction or damage being hereafter termed Damage

b) under the Business Interruption Section against loss due to interruption or interference with the Business directly arising from Damage and as otherwise more specifically detailed herein'.

(2) The insuring clause at the head of the Business Interruption section of the Policy read as follows:

'If any property owned used or otherwise the responsibility of the Insured for the purpose of or in the course of the Business suffers Damage as defined or there occurs an event or circumstances as described elsewhere in this Section of the Policy and the Business be in consequence thereof interrupted or interfered with the Insurers will pay

to the Insured the amount of the loss resulting from such Interruption in accordance with the provisions contained therein'.

(3) The Trends Clause:

'In respect of definitions under 3, 4, 5 and 6 above for Gross Revenue and Standard Revenue adjustments shall be made as may be necessary to provide for the trend of the Business and for variations in or special circumstances affecting the Business either before or after the Damage or which would have affected the Business had the Damage not occurred so that the figures thus adjusted shall 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'.

(4) The Prevention of Access (POA) Clause:

'This policy is extended to include reduction in Revenue incurred by the Insured:
a) arising out of Property in the vicinity of any location owned occupied or operated by the Insured suffering Damage or being closed (in whole or part) or deemed unusable by a competent authority and which shall consequently prevent or hinder the use of the location concerned or access thereto whether Property Insured shall be damaged or not;...'

(5) The Loss of Attraction LOA Clause:

'This Policy extends to indemnify the Insured in respect of a reduction in Revenue resulting directly from loss destruction or damage to property or land in the vicinity of any premises owned and/or managed by the Insured and insured under this Policy'.

The insured recovered indemnity under the provisions of the POA and LOA clauses. That left the issue of business interruption to be resolved.

Issues raised on appeal

On appeal OEH raised the question on how the policy would respond in the circumstances where the insured premises and the vicinity around the insured premises were damaged. It was contended further that OEH suffered business interruption losses as a result of the damage to the insured premises and as a result of the damage to the vicinity, the cause of both forms of damage being the same Hurricanes Katrina and Rita.

The property damage policy was an all risks policy. The trends clause associated with the business interruption section included a 'but for' causation test. The policy had a sub-limited prevention of access and loss of attraction cover. The insurers did not dispute that indemnity existed with respect to the physical damage to the insured premises, caused by the hurricanes. However, in respect of the business interruption losses , insurers argued that this

was not covered. The reason advanced by the insurers, was that even if the hotel had not been damaged, the damage caused by the hurricanes to the surrounding area were of such a nature that the insured would have suffered business interruption losses in any event. Because of damage to the surrounding area the hotel would not have attracted any business. The argument of the insurers was that the required causal test for the business interruption losses could not be satisfied. The submission was that the insured peril was the damage to the hotel itself, and the event which caused the actual physical damage i.e.. the hurricanes, were considered as a cause which competed for the business interruption.

Decision

The Court reduced the issues down to two simple questions:

Question 1: Whether … the policy provides cover in respect of loss which was concurrently caused by: (i) physical damage to the property; and (ii) damage to or consequent loss of attraction of the surrounding area (post para 18);

And concluded (par 41). The answer to the first question of law is therefore "Yes" unless the application of the "but for" test means that the loss claimed was not caused in fact by physical damage to the insured property." (post para 41)

Question 2: Whether … , the same event(s) which caused the damage to the insured property which gives rise to the business interruption loss is also capable of being or giving rise to 'special circumstances' for the purposes of allowing an adjustment of the same business interruption loss within the scope of the "Trends Clause."

The court concluded the answer to question 2 is "Yes"

Consequently the court found the tribunal had not made any error of law and did not overturn the decision of the tribunal.

Discussion

The consequence of the answer to question 1 is thus only consequential losses caused by the damage to property are recoverable. The consequence of the answer to question 2 is in

determining the revenue during the indemnity period that fact that the hurricane damage to the surrounding area would have reduced the to zero had to be taken into consideration.

The decision of the tribunal and the court accords with the historical purpose of the interruption policy. That purpose was to augment the indemnity provided by the property damage policy to include consequential losses. Thus the question becomes what revenue would the insured have earned if the property had not been damaged based on the previous year's figures adjusted to the prevailing circumstances. This revenue would have been zero. The insured earned no income because of the hurricane and in fact earned no profit. .

The application of the trends clause relates specifically where there is physical damage. In this case there was physical damage to the insured property, so the application of the trends clause was correct. Neither the tribunal nor the high court considered the implications of the extensions to the policy. The extensions provide cover for damage to third party property. So if cover is to be provided because of damage to surrounding area that cover is from the extensions. It is not possible to extend the main policy to provide this cover.

An appeal was noted against the High Court decision which was not proceeded with as the parties settled the matter.

The decision in this case was correct but was reconsidered in the Covid litigation both in the UK and SA where it was "overturned". It is distinguishable from the Covid-19 cases in this respect. The case involved physical damage to the insured property whereas the Covid litigation did not. There in fact was no need to overturn this decision in this case as there was physical damage, and the trends cause then became applicable. It is argued in the case of non-physical damage the trends clause in not applicable (Vivian, Spentzouris and Taylor 2022). This is a further reason why the Supreme Court in the FCA case did not need to overturn this case. It was simply not applicable to the Covid litigation.

ANNEXURE "D" *TKC LONDON CASE*

TKC LONDON LIMITED V ALLIANZ INSURANCE PLC

[2020] EWHC 27 10 (Comm.)

Facts

The insured TKC London ran a café business in London. At the outbreak of Covid-19, government regulations forced the café to close from 21 March 2020 to 4 July 2020. It was forced to stop selling food and drink for consumption on the premises as a result of the provisions of Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 (the Coronavirus Regulations). Clearly the food and other perishables, not consumer perished. TKC London then submitted a claim as a business interruption claim. This was one of the first business interruption cases heard during Covid-19. One would normally regard this as a property damage claim, the deterioration of stock but the TKC persisted with the claim as a business interruption claim. Presumably TKC was embolden by the FCA's success before the SC.

The insurer Allianz made an application to strike out the claim alternatively summary judgement. This is similar to what happened in the US. The cases were dismissed without going to trial.

Policy Wording

The business was insured on an All-Risks basis under a 'Commercial Select' policy, which included cover for damage to property including business interruption. The All-Risks policy covered 'Damage to Property Insured at the Premises'. Damage was defined as the 'Accidental loss or destruction of or damage to Property Insured'. Property. Property Insured included 'buildings, contents, stock, and other items shown and/or described in the schedule. The insured claimed that it was entitled to be indemnified in respect of the losses which it had suffered as a result of the forced closure, which amounted to an interruption or interference with its business.

The business interruption section of the policy made provision for business interruption cover 'by any Event'. 'Business Interruption' was defined as 'loss resulting from loss or interference with the Business carried on by the insured at the Premises 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 or destruction of or damage to property'. It refers to an

occurrence, with the fundamental point being that the policy only reacted to 'Business Interruption by any Event'.

Included in the policy was a 'basis of settlement' clause which provided: 'the insurer will pay the Insured in respect of each item covered, the amount of their claim for Business Interruption, provided that at the time of any event (a) there is an insurance in force covering the interest of the insured in the property at the Premises against such Event; and that (i) payment has been made or liability has been admitted for payment…' Both these sections contained specific exclusions from indemnity. The most important exclusions, were for damage/business interruption caused by or consisting of 'inherent vice' and 'gradual deterioration'.

Submissions made by the parties

It was argued by the insurer that the allegation by the insured that it had suffer 'Business Interruption by an Event' did not amount to same as it was merely a temporary closure of business, which did not satisfy the requirements of an 'Event'. It was submitted that both 'destruction' and 'damage' indicate that in the definition of 'Event', these words imply a loss which amounts to a physical loss. Physical loss required to be more than a temporary loss or deprivation.

Allianz submitted further that the 'basis of settlement' clause required that insurance needed to be in place 'covering the interest of the insured in the property at the Premises against such Event.' As TKC had acknowledged that it had not claimed for any physical damage in relation to any 'Event', except for the claim under the business interruption section, it followed that the insurer had not obligation to make payment for this claim. The wording of this policy was standard wording used by Allianz, which purpose was to make good consequential business interruption loss, for cover for the underlying damage to the insured property.

Decision

The Court held that the trigger required in terms of the policy was that physical damage to the insured property must occur. No such event occurred. The damage to the property was not 'accidental', as it was as a result of natural deterioration much like an inherent vice. The stock had not been physically damage by the insured peril. Because the stock had deteriorated, it could not be used for the purpose of human consumption.

It was accepted by the Judge that the mandatory closure of the insured's premises as a result of Government Regulations amounted to an 'interruption of or interference with the

Business carried on by the Insured at the Premises' and that the interruption or interference was 'in consequence of an event to property used by the Insured at the Premises for the purposes of the Business'.

The crucial issue to be decided by the Court was whether the mandatory closure could be construed as 'accidental loss...of ...property' in accordance with the definition of 'Event'. The Judge held that the meaning of the policy wording suggested that 'loss' was intended to relate to physical loss or damage. Considering the definitions above, 'Event' could not reasonably be interpreted to mean a mere temporary loss of the use of the property. On this basis, the court held that the claimant did not have a valid claim in law based on the contract, for the temporary loss of its business premises. The Judge relied on the legal rules of interpretation of contract to reach the decision in this matter. Judges are as a rule reluctant to deal summarily with a matter but in this case the judge decided he should do so to being certainty. He ended his judgement by citing he authors of the BIICL Concept Note 'Breathing Space':

> '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……'

Discussion

Unlike the FCA test case, this case involved the standard main policy not an extension. As indicated above what is needed to lead to recover is firstly physical damage to property caused by an insured peril and then secondly consequential damage brought about by the physical damage. This case involved the first part of the enquiry; did the insured peril cause the physical damage. The court concluded it did not and thus there is no need to proceed to the second party. The decision of the judge is in line with the 2 000 US cases which rejected the cases for lack of the defined physical damage. As in the US cases the judge did not send the case for trial but summarily dismissed the case.

The court was thus not required to consider any disease or denial of access clauses. It was the first case in the UK where the court dismissed the case because of the absence of an accidental event which caused 'physical loss' to property. The issue was rather there was no accidental event. The deterioration of stock certainly involved property damage – so physical damage to property was indeed proven since it did exist. The US cases involved claims for the loss of revenue – not damage to property. The novel thing about this case is the attempt to bring physical damage under the heading of business interruption. Usually, stock claims would

come under the All-Risks property damage policy. This requirement has been emphasised by the US courts, and a failure to prove physical damage, results in decisions by the court to dismiss this matters.

ANNEXURE "E" BI CASES PRIOR TO THE SOUTH AFRICAN BI CASES

GOVENDER V MUTUAL AND FEDERAL INSURANCE COMPANY

2005 CLR 257 (D)

Facts

Govender entered into insurance contracts with Mutual and Federal Insurance Company, utilizing the industry Multimark III Policy document. This document contains a number of sections which when selected provides the cover. The fire section was selected and provided cover for fire damage. There is also a business interruption section which also was selected. Business interruption cannot be selected without also selecting a property damage section. Thus, this accords to the historical position of involving two policies; the fire property damage section and the BI section. In terms of the operative clause of the BI section cover is provided in respect of loss which occurred as a result of the interruption of or interference with the business which occurred as a result of damage occurring at the insured premises in respect of which payment has been made, or liability admitted by the insurer under the fire section. Each section has its own schedule. There is thus a schedule for the fire section and another for the BI section.

The schedule attached to the policy, described the properties as 2 Rana Road and 4 Rana Road, Isipingo Rail. A schedule was also attached to the business interruption section, and in that schedule, the description of the premises was only 2 Rana Road Isipingo Rail. Approximately three months after the inception of the policy, a fire occurred at 4 Rana Road, Isipingo Rail. So, the premises at which the fire occurred was listed as the insured property which was damaged by fire, but the business interruption section did not indicate the same property. The insured claimed and received payment of an amount of R400 000 from the insurer in respect of the incident for the property damage claim. But the insurer however repudiated the claim of R637 000, made under the business interruption section of the policy alleging the premises was not insured since it was not included on the BI schedule.

Decision

The court held in order to give business efficiency to the business interruption section of the policy, and to elicit the plain meaning of the words thereof, the policy must be read with the idea of identifying the premises in respect of the which payment had been made or liability

admitted under the fire section of the policy. No reference was made to the schedule attached to the policy in the interruption section.

The language of the business interruption section of the policy indicated that the intention was to provide cover for the interruption of the insured's premises damaged by fire as indicated in the fire section of the policy. The premises which was damaged by the fire was the premises identified in the fire schedule. In this case, the fire had occurred at 4 Rana Road, Isipingo Rail, and the business interruption had therefor occurred as a result of the fire, at the premises covered by the fire section. Confusion was caused because of the insertion of the address 2 Rana Road, Isipingo Rail, in the business interruption schedule. The argument presented was that since the operative clause of the business interruption policy did not refer to the schedule but only to what was covered by the fire section, then all the premises referred to in the fire section schedule of the policy were covered against the business interruption loss.

To the extent that the uncertainty was created by the writer of the policy being the insurer, the interpretation then of the policy was against the writer of the policy in terms of the *contra proferentem* rule was applied. The Plaintiff's claim was granted.

Discussion

The Multimark III Policy was the policy containing numerous types of cover provided for under various sections (Vivian, 2005). Depending on the type of cover required, the insured would select the appropriate sections. As pointed out by Vivian (2005), the sections do not 'always dovetail seamlessly' as in this case and often in some cases, sections are used by the courts to arrive at a decision which do not necessary fit together. The courts have even referred to sections not selected by the insured 'This is tantamount to the court using a contract that is not before it to reach a conclusion about a contract that is!' (Vivian, 2005). Clearly there is a need for the industry to tighten up on its administrative procedures; which it continues to fail to do as indicated by the Covid litigation. The industry did not learn.

The following point was made by Vivian (2005), accepting the decision as being correct:

- Cover that is provided in terms of the business interruption section of the policy, is in fact being provided for all the premises listed under the fire section, which inevitably increases insurers to increased exposure;

- The suggestion was made that the operative clause of the interruption section should be revisited to ensure clarity of which insured premises are covered in respect of each section; and
- The sections of the Multimark III Policy which are not selected as part of the cover, should be removed to avoid creating unnecessary confusion.

Clearly this case did not deal with the fundamental principles of BI insurance and is thus of little assistance with this dissertation. Its value is to demonstrate the correctness of the statement made that this class of insurance has not had much benefit from judicial insight.

The two sections which were selected did not dovetail neatly together – an administrative problem – a similar problem occurred in the Covid-19 litigation. So, in this sense the judgement is of importance.

CHEMALUM (PTY) LTD V MUTUAL & FEDERAL INSURANCE CO LTD
[2006] JOL 16404 (D)

This case is the High Court case which was taken on appeal. The appeal is discussed after the High Court decision.

Facts

Chemalum had instituted a claim against its MultiMark III business interruption policy for indemnification caused by an interruption of its business when its premises was damaged by fire. As is the case with BI insurance, cover was on the basis of the 'reduction in turnover' and an 'increase in cost of working'. The indemnity was stated to be:

> '(a) in respect of reduction in turnover the sum produced by applying the rate of gross profit to the amount by which the turnover during the indemnity period shall, in consequence of the damage, fall short of the standard turnover;
>
> (b) in respect of increase in cost of working the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in turnover which, but for the expenditure, would have taken place during the indemnity period in consequence of the damage, but not exceeding the sum produced by applying the rate of gross profit to the amount of the reduction thereby avoided, less any sum saved during the indemnity period in respect of such of the charges and expenses of the business payable out of gross profit as may cease or be reduced in consequence of the damage'.

In addition, there was a proviso to the contract, the so called average proviso, in terms of which the parties agreed that:

> 'the amount payable shall be proportionately reduced if the sum insured in respect of[insured] gross [profit] is less than the sum produced by applying the rate of gross profit to the annual turnover where the maximum indemnity period is 12 months or less, or the appropriate multiple of the annual turnover where the maximum indemnity period exceeds 12 months'.

'Annual turnover' was defined as '[t]he turnover (revenue) during the twelve months immediately before the date of the damage'.

It was agreed prior to trial by the parties that the insured's claim was based on the turnover during the twelve-month period prior to the occurrence of the damage to the premises. The insured's standard turnover amounted to R9 058 770, but because of the loss the actual turnover was R4 406 855 giving a shortfall, reduction or shortage of turnover, of R4 651 909. The view that was agreed by the parties based on expert advice, was that the turnover trend of the insured's business would in the absence of the damage have been sharply upward. The converse was that the trend would not be accurately reflected if the period prior to the damage was taken int account. They agreed further that the average turnover for a period of two months some two years after the damage (R754 897) should be multiplied by twelve to provide the projected standard turnover of R9 058 764. Applying a rate of gross profit percentage of 57 per cent, based on a conservative estimation provided by an expert, to this shortfall, it was agreed that the insured's loss of gross profit amounted to R2 651 588. The argument presented by the insurer was that since the sum insured was less than the full amount payable as an indemnity, the formula in the policy would then be used to calculate the amount payable being proportionally reduced, as per the policy. The amount payable to the insured was agreed at R2 651 585, which was less than the indemnity of R3 million. The submission made by the insurer was that the amount payable then had to be proportionally reduced. As the insured should have insured for R5 163 495, being 57% of its projected annual turnover of R9 058 764, there was a 58% underinsurance which, if applied to the amount of the insured's loss which was R2 651 585, meant that the insured could claim only R1 337 923.

The court disagreed with the argument presented by the insurer in respect of under-insurance and the calculation for the reduction of the insured's claim. The court was of the view that the insured's claim did not have to be reduced at all. The court noted that the indemnity was in respect of a loss of gross profit and that the insured sum was R3million.

In consideration of the terms of the average clause, the question was whether the sum produced by applying the rate of gross profit to the 'annual turnover' exceeded the amount insured. The 'annual turnover', was distinguished from the 'standard turnover'. The 'standard turnover' made provision for upward or downward adjustments, which was dependant on the trends of the business. On the agreed figures, the annual turnover of the insured would have been R1 477 077, in contrast to the agreed standard turnover of R9 058 764. 57% of which was an amount of R841 893, which was significantly less than the sum insured.

Discussion

This case deals with the application of the average clause to BI insurance. The application of an average clause, , means that in the event of an insured being underinsured, then amount recoverable by the insured for its loss will be reduced proportionally. In this case, the average clause made provisions for the instances where the insured would be underinsured. On the interpretation of the average clause in this case, the court did not find that there was underinsurance and accordingly there was no proportional reduction of the amount payable to the insured. The insurer, dissatisfied with the interpretation of the court, took this decision of appeal.

MUTUAL AND FEDERAL INSURANCE CO LTD V CHEMALUM (PTY)LTD

2007(2) SA 479 (SCA)

Facts

The SCA was faced with the task of interpreting these complicated provisions in a Multimark III business interruption policy. On appeal the insurer once again argued for a reduction in the amount of the award, based on the provisions of the 'average clause'. The response of the insured was that the award did not fall to be reduced in terms of the average provision. The main thread of the argument of the insured, was that 'annual turnover' was different to 'standard turnover', and that no evidence had been presented to the court as to 'annual turnover'.

Decision

The SCA upheld the appeal with costs and held that (at paragraph 14):

> ' since the period over which the standard turnover was determined (12 months immediately before the damage) is the same as the period over which the annual turnover is to be calculated,

and the same adjustments are required to be made to both amounts, the figure for both must necessarily be the same, viz R9 058 770(the agreed standard turnover). When the agreed rate of gross profit (57%) is applied to the annual turnover (R9 058 770) the result produced R5 163 495'.

As the sum insured was less than this amount, in effect the insured was underinsured and the amount payable as indemnity, accordingly, had to be reduced proportionately; average had to be applied. As there was no dispute that the rate of underinsurance was 58%, applying this rate to the amount payable as indemnity for the loss of gross profit, the amount payable to the insured was confirmed to be an amount of R1 537 920.

Discussion

Although the issues appear to be complex when approached from first principles, they become clearer.

- Firstly, the point of departure is to determine the standard turnover. That is the turnover which would have been generated if the loss did not occur. To arrive at this figure the trends clause needs to be applied.
- Secondly the actual revenue generated is determined,
- The revenue loss is the difference between the two.

Clearly the standard turnover needs to be compared to the insured amount, the annual turnover. If the standard turnover is less than the annual turnover then the insured was underinsured, and average applies.

It is apparent from these cases that the focus of the argument was on the calculation of the damages for business interruption loss via the policy wording and not the fundamental principles underlying business interruption insurance. It is thus agreed that the SCA came to the correct decision.

PFC FOOD CC V THREE PEAKS MANAGEMENT (PTY) LTD (5573/2009) [2012] ZAKZDHC 57 (10 SEPTEMBER 2012).

Facts

Three Peaks was the broker and PFC the insured. The broker placed the cover with and insurer and when a loss occurred it was discovered the insured was under-insured and the insurer applied average. The broker was successfully sued for the amount the insured was under insured. The court decided the broker should have explained how the BI loss (sic) [Sum insured] should a have been calculated. The broker should have obtained sufficient information

to ensure the insured was not underinsured and warned the insured it could have been under insured.

Discussion

The case did not deal with the general principles of the BI so the case also illustrates the point made in the dissertation that the BI policy has had little judicial attention, It can be added, as pointed out in the dissertation that the BI policy is regarded as the most complex of the non-life policies and with all respect to the judge it is highly optimistic to believe the average small broker would know how to calculate the sum insured or determine if the insured is under-insured. The broker in fact did the sensible thing and put the insured in touch with the person within the insurer who could advise on these things. Since to determine the sum insured would require a detailed analysis of the insureds financial statements and the insured was well aware that the broker had not asked for these or provided with these that the broker had in fact not carried out these calculations, so the broker did not mislead the insured on this point.

Again, to emphasis the point the case did not deal with the fundamental principle of the BI policy and thus does not contribute to the understanding of the policy.

ANNEXURE "F" SOUTH AFRICAN COVID CASES

CAFÉ CHAMELEON CC V GUARDRISK INSURANCE CO LTD

(5736/2020) [2020] ZAWCHC 65; [2020] 4 All SA 41 (WCC)

Facts

This matter came before the High Court of the Western Cape. The Applicant sought a declaratory order that the insurer was obliged to indemnify it. Judgement was handed down on the 26 June 2020. The Applicant, Café Chameleon conducted business of a restaurant and applied to court for relief, ordering its insurer Guardrisk to indemnify it in terms of the business interruption section of its business policy. The Applicant had suffered loss as a result of the promulgation and enforcement of government regulations made under the Disaster Management Act 57 of 2002. It applied further for interim relief in the form of payments to the business in order to enable it to survive.

Guardrisk based its opposing arguments on four main grounds: i) on the basis that the matter was not one of urgency as the Applicant was not entitled to relief in terms of the policy; ii) that the relief sought was inappropriate; iii) that the loss sustained by the Applicant, was not covered under the Infectious Diseases Extension; and iv) that there was no causal link between the lockdown Regulations and the Infectious Diseases Extension (paragraph 2).

Issues to be decided on submissions made by the parties

The following facts were common cause:

- That the policy was in force and that the events which gave rise to the claim which occurred on the 20 March 2020, was within the period of indemnity;
- That on the 15 March a national state of disaster had been declared in accordance with the provisions of the Disaster Management Act no 57 of 2002;
- That a 'lockdown' was introduced on the 25 March 2020, that restricted the movement of people during specific periods and movement wad only permitted for essential requirements to provide for essential basic needs, to obtain social grants or seeking emergency, life-saving or other chronic medical attention;
- That all places and premises as listed in the Regulations e.g. restaurants, retail, entertainment, and other non-essential services were closed;
- The lockdown was further extended until 30 April 2020; and

- Whether the matter was one of urgency, which the court held that it was as the circumstances required to prove that the matter is rendered urgent, were satisfied.

The Applicant submitted that the Disaster Management Regulations effected its business, as although it was able to open from 1 May 2020, it had suffered loss effective from 25 March 2020 until 30 April 2020, due to the fact that it was closed during this period. Effective from 1 May 2020, it was permitted to open and start operating, and could sell food, it could only do so on a takeaway basis, as no customers were yet permitted to sit and eat at the premises because of the restrictions on personal movement. As its business was primarily a sit-down business, although it was permitted to sell takeaways, it still was not able to trade to its full capacity or to serve its customers at the premises. The Lockdown Regulations therefor severely affected its operations, which impacted on the employment of its workforce. It did not retrench any staff and ensured during the period of lockdown and reduced operations; it paid the full wage bill for March 2020. It applied for relief from the Covid-19 TERS National Fund and only received a portion of the wage bill. The sole-member of the Applicant used his own funds to assist the business and its employees as best he could, but eventually ran out of funds.

The Applicant argued that 'once Covid-19 was by law reportable to a competent local authority, it matters not that the source of that obligation is national legislation, rather than an ordinance, bylaw or other subordinate legislation enacted by a local authority' (paragraph 19). This was irrelevant when considering the seriousness of the peril which was insured against under the Notifiable Disease Extension. On a proper interpretation of the Notifiable Disease Extension, the indemnity which provides cover for 'human infectious or human contagious disease, an outbreak of which the competent local authority has stipulated shall be notified to them' falls within the ambit of the extension. The following important principles were considered by the High Court.

Submissions made in relation to the interpretation of contracts

There was much argument by both parties regarding the interpretation of the contract in the form of the policy which was in place and applicable. The court referred to a number of cases of the High Court when considering the principles applicable to the interpretation of contracts. *City of Tshwane Metropolitan v Blair Atholl Homeowners Association* (2019, at para 61) where it was held that when considering the wording used, these must be considered in consideration of the context in which they were used, and not narrowly or in isolation. The court referred to the case of *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2010) where the court held that 'the purpose of the provision being interpreted' must also be considered in the

enquiry and to determine the context of the provision being interpreted. A sensible, holistic, unified, and business-like interpretation must be afforded to the words being considered.

The Applicant submitted further in respect of the interpretation of the words, that i) the interpretation of the policy must not take into account the views and reservations which were common in the industry but which the Applicant had not knowledge, about liability under the Notifiable Disease Clause; ii) the existence of other policies, which were not disclosed to the Applicant, could not be referred to; iii) generalized concerns about the pandemic and its impact on the insurance industry were immaterial in the event that the Respondent insurer had made no attempt to conduct an assessment of the actual or anticipated impact of Covid-19 on its business.

The Respondent argued the following:

- Although prior to the Covid-19 pandemic, there were policies which the Applicant could take which would have provided the required cover in the circumstances of a national lockdown, yet if failed to take up such policy;
- The general view of the insurance industry was that losses sustained as a result of the national lockdown did not fall within the parameters of what peril is indemnified under a Notifiable Disease insuring clause;
- That if insurance is provided, without due consideration of the applicable terms and conditions of a policy, to insureds thereby providing indemnity within the policy for Covid-19 losses which had been suffered, the argument made was that the potential effect of this on the industry would be to destabilise, not only the South African insurance market, but the global market as well;
- That the insured had the option to purchase policies which would provide indemnity for instances like the current Covid-19 losses, but failed to do so;
- The meaning of the word 'businesslike' in *Grand Central Airport (Pty) Ltd v AIG SA Ltd* (2004, at para 9), was used to support the argument that an interpretation of the wording of an insurance policy, must be aligned to 'sound commercial principles and good business sense, so that its provisions receive fair and sensible application.'

The wording of the policy

> 'interruption or interference with the business due to……..(e) notifiable Disease occurring within a radius of 50 kilometres of the Premises.

Special Provisions

(a) Notifiable Disease shall mean illness sustained by any person resulting from any human infectious or human contagious disease, an outbreak of which the competent local authority has stipulated shall be notified to them but excluding Human Immune Virus (H.l.V), Acquired Immune Deficiency Syndrome {AIDS) or an AIDS related condition.'

Although Guardrisk admitted that Covid-19, being a human infectious disease, and that there had been an outbreak within the 50 kilometres radius of the insured premises, it denied that the competent local authority had stipulated that they had to be notified of the outbreak. In addition, it submitted that the interruption of the insured's business was caused by the regulations imposed to prevent the spread and curtail the increased number of cases. The reason was not that there had been an outbreak in that particular area. On this basis, the Respondent submitted that the insuring clause does not apply to the Applicant's claim. The court refused to accept these arguments, stating that they were misguided and did not accept these submissions. It determined that Covid-19 being a respiratory disease, fell within the parameters of the Surveillance Regulations promulgated in the Government Gazette notice 1434 dated 15 December 2017, which defined communicable diseases and notifiable medical conditions, and therefor fell within this clause.

The importance of this determination is that according to the court, Covid-19 was by law reportable to a competent local authority, and that the source of that obligation was immaterial. At paragraph 62, Le Grange J stated:

'Based upon an interpretative approached, the principal reason why the notification requirement was introduced to the Notifiable Disease Extension, was to ensure that cover thereunder would be triggered only by outbreaks of the most serious diseases, and not whether the source of that obligation to report the gravity of the threat was national legislation, rather than subordinate legislation enacted by a local authority.'

The trigger of the extension was the obligation to report the disease to a local authority. To interpret these words in any other manner, as pointed out by the court, would in effect narrow the interpretation of the wording of the policy. In respect of the interpretation of the policy, the court applied these principles and held against the Insurer, stating (paragraph 66) that 'in accordance with sound commercial principles and good business sense, so that its provisions receive fair and sensible application.'

Causation

Le Grange at paragraph 67 in considering the issue of causality, referred to the trite principle in respect of insurance. For a claimant to successfully claim under a policy of indemnity, the claimant is required to prove that the peril occurred, which caused the loss which sustained by the claimant/ insured, but to also prove the causal nexus between the peril and the losses suffered (Reinecke MFB, Nienaber pm & van Niekerk JP, 2013). Cover in this case was promised in the event that the insured suffered an 'interruption or interference with the business due to……..(e) notifiable Disease occurring within a radius of 50 kilometres of the Premises.'

Relying of the principles enunciated in *Napier v Collett and another* (1995) *and Petropoulos and another v Dias* (2020)*,* the question to be determined is whether Covid-19 as a Notifiable Disease, was the cause or materially contributed to the 'lockdown regulations' which gave rise to the insured's claim. It not then legal liability would not arise. The issue of the remoteness or proximity of the harm then is relevant to determine that the harm was sufficiently close or direct or legal liability to be incurred. If the harm is too remote, then there is legal liability is incurred.

In considering the issue of causation *Napier v Colette and another* (at paragraph 72) was relied on.

> 'The general approach to questions of causation as laid down in the context of criminal law and the law of delict, based as it is on principle and logic, is equally applicable to insurance law, although its application will be subject to the provisions of the policy in question. A particular policy will, however, seldom affect the basic approach which requires, in the first place, and inquiry into the presence of 'factual causation'. If this initial enquiry leads to the conclusion that the prior event was a causa sine qua non, of the subsequent one, the further question of whether the relationship between the two events is sufficiently close for the form of deposit to the legal cause of the latter rises. In answering this question in the context of insurance law, prime regard must be had to the provisions of the policy question, which may extend or limit the consequences covered. In addition, the specific provisions, matters such as the type of policy the nature of the risk insured against, and the conditions of the policy may assist the court in deciding whether the factual cause should be regarded as the cause in law'.

The court at paragraph 73 referred to the 'but for' test much like the UK court would do in FCA test case which was discussed in the appeal to this case. . It was held that there was a clear nexus between the Covid-19 outbreak and the regulatory regime which resulted in the lockdown of the Applicant's business. The argument by the insurer that the regulations were

introduce to 'flatten the curve' which was unrelated to the outbreak of Covid-19 was not accepted by the High Court. It held that factual causation had been established.

Legal causation was also considered. Relying on the case of *International Shipping Co (Pty) v Bentley (Pty) Ltd* (1990), to consider the position in respect of legal causation, it considered factors such as directness, a *novus actus interveniens,* legal policy, reasonableness, fairness, and justice. After considering the facts of the case, the court held in favour of the Applicant that legal causation was established.

Decision

The High Court held (at para 37) that:

> '….it is evident that an insurance policy has to be interpreted so that its provisions receive fair and sensible application and that a restrictive consideration of words without regard to context has to be avoided. It cannot be that the Policy under consideration must be interpreted with reference to other policies or on the basis of generalised concerns about the impact of Covid -19 on the insurance industry at large, of which the Applicant had no knowledge of. The Policy under consideration must therefore be considered on the contractual terms to which both parties had assented to, in a sensible manner which underpins sound commercial sense, and not have an un-business-like result.'

The court dismissed the argument presented by the Respondent concerning the significant demand on the resources of insurers, that these cases would make under the Covid circumstances. In essence the argument is the cost imposed by the lockdown could impose unaffordable costs on the insurance market. It concluded that this argument could not be used as a basis upon which consider the meaning of the Notifiable Disease Extension in any other way than that interpretation given by the Applicant. The argument that the admission of this claim would open the floodgates of liability for the insurer was also dismissed by the court. The 'gloomy predictions of industry collapse within the insurance world' as submitted by the insurer were dismissed, as being nothing more than speculation. However, the court added, that even if this were accurate, this cannot be the reason why an insurer would not be held to keep its promise and to provide the indemnity in accordance with the policy. The insurer cannot be 'excused from honoring its contractual obligation because its business has unexpectedly incurred greater debt than had been expected.'

The court granted the declaration that the insurer was liable to indemnify the insured [par 85].

Discussion

In reaching its decision to uphold the provisions of the insurance contract and the ensure that the insurer kept its promise, the High Court focused on issues of causation and interpretation of contract. There were no arguments which dealt with the fundamental principles of consequential loss that it was designed to cover consequential losses arising out of physical damage to insured property. Earlier consequential loss cases where not presented to the court. There was no discussion on how to reconcile the extension to the main policy. The Respondent was declared to be liable to indemnify the Applicant in terms of the business interruption section of the policy and was ordered to make payment for the losses incurred by the Applicant.

A conclusion to this dissertation is that nonmaterial losses do not fit within the BI policy and that were non-material losses are insured this should be in terms of a separate policy.

GUARDRISK INSURANCE COMPANY LTD V CAFÉ CHAMELEON ZASCA 173

The Guardrisk case was taken on appeal as discussed below.

MA-AFRIKA HOTELS (PTY) LTD, THE STELLENBOSCH KITCHEN (PTY) LTD v SANTAM LTD

(6499/2020) [2020] ZAWCHC 160; [2021] 1 All SA 195 (WCC) (17 November 2020)

Facts

The Applicants operated different entities as hotels and restaurants in the Western Cape. They each had cover which provided for business interruption, which an extension which also provided cover in the infectious disease clause. The five policies which covered the Applicants all contained the same wording. The Applicants sough declaratory orders, to the effect that the Respondent was liable to indemnify them in terms of the business interruption section of the policies for losses '…Occasioned by the occurrence of a notifiable disease in the form of Covid-19 occurring within a radius of 40 kilometers of the insured premises'. The Applicants also sought an order from the court that the indemnity period for the loss was for a period of 18 months.

The Applicants had cover with an Infectious Disease extension providing cover for:

'Loss as insured by this Section resulting in [from] interruption or interference with the Business due to…
a) …

b) Notifiable Disease occurring at the Premises or attributable to food or drink supplied from the Premises
c) ...
d) Notifiable Disease occurring within a radius of 40 kilometres of the Premises
e)...
"Notifiable Disease" was defined as "illness sustained by any person resulting from: (ii) Any human infectious or human contagious disease an outbreak of which the competent local authority has stipulated shall be notified to them'.

The Respondent relied on the same arguments as submitted by Guardrisk in the *Café Chameleon v Guardrisk Insurance Company* case. The insurer argued that the court in that case erred, in particular in respect of the identification of the insured peril. The High Court identified the central issue to be considered, was how the policy would be interpreted, in consideration of the nature and scope of the insured peril and whether business interruption and resultant loss therefrom, was caused from the insured peril. In order to make this assessment, the court considered the proximate cause of the loss. Legal and factual causation tests were applied to the facts before the court, in order to make this determination (paragraph 32).

Decision

The FCA test case was considered and relied on in depth by the court, particularly focusing on the cause of the business interruption losses and what was the trigger for cover to provide the indemnity. Was the trigger the occurrence of Covid-19 within a certain radius or was the closure of the business due to government regulations due to Covid-19 the trigger. The court in the FCA case held that on a proper interpretation of the wording, it was not necessary to have the occurrence only on the local area (paragraph 71). The notifiable disease by its very nature had the ability to spread widely. The court held further that the issues of causation were immaterial in this instance, as the nationwide outbreak of Covid-19 and the government's response together formed a 'composite peril.' This reasoning of the court in the FCA High Court matter, in respect of causation was found to be persuasive and was followed by the High Court in this case. i.e.. Covid-19 and the regulations being indicative of the government response to Covid-19, were also considered as a 'composite peril' and as such could not be considered separately (paragraph 73- 75).

The High Court was satisfied that both factual and legal causation had been established. It concluded that the national response to the COVID-19 disease that has a local occurrence was sufficient to satisfy the policy. It stated that: '[h]ad it not been for Covid-19 and the government's response, the applicants' business would not have been interrupted and they

would not have suffered their loss. In our view the applicants' losses are exactly what they had insured themselves against' (paragraph 75). In respect of the interpretation of the wording of the policy, the court stated that 'a purposive approach to the interpretation of the policy wording is required, in a manner that provides an interpretive outcome that is fair, sensible and business-like'.

The High Court further considered the application of the trends clause. The Respondent relied on the approach set out in *Orient-Express Hotels* case, which, in context, the Respondent argued allowed for a narrow interpretation of the insured peril. The court followed the approach of the High Court in the FCA test case, in respect of the *Orient-Express Hotels* decision, and its application of the trends clause. The approach to the trends clause was that no part of the insured peril should be taken into account in quantifying the loss sustained (paragraph 80). 'In the context of the subject extension, the Court found that the correct counterfactual was a world without Covid-19' (paragraph 84; HFW, 2021).

The declaratory relief which the Applicants sought was granted as prayed. The Applicants 'established that they have an existing contractual rights to indemnity under the infectious diseases clauses to the policies, and to an indemnity period of eighteen (18) months.' (paragraph 91). Cloete J wrote the second concurring judgment, which agreed with the result but for different reasons.

Discussion

The matter went on appeal to the SCA as Santam was not satisfied with the manner in which the High Court interpreted the issue of causation and the insured peril, the trends clause and the indemnity period. Santam challenged the decision of the High court in respect of the indemnity period, submitting that the policy defined the 'indemnity period as commencing with the damage as contemplated, which results in the loss, and ends 'not later' than the number of months thereafter stated in the schedule during which the result of the business shall be affected in consequence of the damage'. The Respondent submitted that the indemnity period was a period of three months, as stated in the business interruption section of the policy wording. The judgment is long and complex but has been competently summarised by the Registrar of the SCA. The following important points of the judgement were noted by the Registrar:

- In analysing a policy in order to determine whether the wording provides cover, the starting point is to identify the applicable sections. In the *Ma- Afrika* case, the business interruption section was determined to be applicable.
- The next step was to 'consider the perils which might result in business interruption, in respect of which the insured would enjoy insurance cover' (SCA Registrar summary October 2021). There was no dispute that notifiable infectious diseases were perils that were covered under the business interruption section of the policy.
- The Main Schedule of the policy then had to be considered in order to determine for which losses following business interruption due to a notifiable disease, indemnity would be provided. The SCA found that loss of revenue and the additional increase in cost of working were covered.
- The period of indemnity was specified in the Main Policy which confirmed this period to be 18 months.
- 'In the court's view, the indemnity period in relation to claims for loss of revenue due to business interruption, ineluctably, was 18 months. In any event, given that the policies were admittedly difficult to navigate, as best for Santam, that there was a meaningful degree of uncertainty concerning the indemnity periods, a conclusion might be reached that on that aspect the policies were ambiguous'.
- In cases of ambiguity, then the *contra proferentum* principle is evoked.

The Ma-Afrika case was taken on appeal with respect to the indemnity period of the notifiable extension.

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In this case the SCA ruled in favour of the insured that the indemnity period is 18 months.

GRASSY KNOLL TRADING 78 CC t/a FAT CACTUS & FAT CACTUS WOODSTOCK(PTY) LTD v GUARDRISK INSURANCE COMPANY LTD
[2021] 1 All SA 503 (WCC)

Facts

The case related to the closure of the Applicants restaurants in Cape Town when they were compelled to do so because of the government regulations enforcing the national lockdown in

March 2020. The Applicants sought a declaratory order, ordering the Respondent insurer to indemnify them in accordance with the provisions of the policy which was in place, in respect of business interruption losses which they had suffered.

Wording of the policy

> 'interruption or interference with the business due to……..(e) notifiable Disease occurring within a radius of 50 kilometres of the Premises.
>
> Special Provisions
>
> (b) Notifiable Disease shall mean illness sustained by any person resulting from any human infectious or human contagious disease, an outbreak of which the competent local authority has stipulated shall be notified to them but excluding Human Immune Virus (H.l.V), Acquired Immune Deficiency Syndrome {AIDS) or an AIDS related condition.'

Guardrisk conceded that Covid-19 was a Notifiable Disease as per the meaning of the aforesaid applicable clause and that cases of Covid-19 had occurred within 50 kilometers of the insured restaurant premises before the closure of the restaurants. The same arguments as made in the *Café Chameleon CC v Guardrisk Insurance Company Ltd* (2020) case, were submitted to the High Court in this matter as well. The Applicants agreed that the occurrence of Covid-19 did not occur within the specified radius and did not cause the closure of their restaurants. The Applicants based their case on the fact that the closure of their restaurants stating that the pandemic and government response to it, was the cause of the closure of their restaurants.

The court considered the decisions of the courts in *Café Chameleon CC v Guardrisk Insurance Company* (2020), *Ma-Afrika Hotels (Pty) Ltd and another v Santam Limited and another* (2020) and noted that the court was bound by the decisions of those courts, unless it could identify distinguishing facts which would justify a different decision.

Decision

Much like the cases which has been argued before this case, the focus of the court was once again on the interpretation of the contract. It is once again interesting to note that there was no consideration by the court on the principles underlying business interruption policies, in reaching the judgement which was reached.

The case of *Centriq Insurance Company Ltd v Oosthuizen* (2019) was cited as authority for the proposition that the usual rules of interpretation, regard being had to the language, context, and purpose of the insurance contract, must be used, favouring a 'commercially

sensible' meaning to one that is unsensible and contrary to the purpose of the policy. This case was used as authority on the specific considerations which apply to insurance policies. The principle of objectivity in the interpretation if the meaning of the words was emphasized. The following principles were also followed:

- provisions in policies which limit or exclude an obligation to indemnify are interpreted restrictively because 'insurance contracts have a risk-transferring purpose' and it is the insurer's duty to 'spell out clearly the specific risks it wishes to exclude' (para 18 *Centriq*. See also *Norwich Union Fire Insurance Society Ltd v SA Toilet Requisite Co Ltd ,*1924 at paragraph 222).
- in the event of real ambiguity, the *contra proferentem* doctrine applies, and the policy is generally construed against the insurer (*Centriq* para 18). Cachalia JA (paragraph 21) cautioned as follows:

  ''[C]ourts are not entitled, simply because the policy appears to drive a hard bargain, to lean to a construction more favourable to an insured than the language of the contract, properly construed, permits. For, if that is what the insured contracted for that is what he is entitled to, and no more. It is not for the courts to construe exclusions in favour of the insured simply because it considers them to be unfair or unreasonable'.

Norton AJ, identified two principal issues of interpretation which the court had to consider. The first was the interpretation of the words defining the nature and the scope of the insured peril and the second, to confirm that a causal relationship existed between the notifiable disease peril and the business interruption. The government measures introduced in response to the notifiable disease had to also be considered as part of the causal matrix.

Discussion

The court in this case approached the matter in the manner the courts had in *Café Chameleon CC v Guardrisk Insurance Company* (2020), *Ma-Afrika Hotels (Pty) Ltd and another v Santam Limited and another* (2020). The approach of the High Court of the Western Cape found support for such approach in the decision of the Queen's Bench in the FSCA test case. No basis was found to find this case distinguishable for the binding case of *Ma-Afrika Hotels (Pty) Ltd and another v Santam Limited and another* (2020). The clause was an identical in its wording and structure and the factual premises and what had transpired with the government intervention was common cause between the cases. The interpretation of the court to the wording of the contracts in the *Café Chameleon CC v Guardrisk Insurance Company* (2020), *Ma-Afrika Hotels (Pty) Ltd and another v Santam Limited and another* (2020), were identical.

Both these cases are examples of how the court applied the spirit of the principle of Treating Customers Fairly (TCF). Although not specifically stated, the courts in coming to the decisions which they did, in these two cases, have in effect indirectly followed a more 'equitable' approach as envisaged by TCF.

Norton AJ, in the *Grassy Knoll Trading 78 C t/a Fat Cactus & Fat Cactus Woodstock(Pty) Ltd v Guardrisk Insurance Company Ltd* (2020) matter, considered the approach of the court in the FCA case. The six of the eight disease clauses which the court was required to consider, with the various variations of the wordings providing for the business interruption, caused by notifiable or infectious diseases within specific radius, provided for losses sustained as a result of business interruption caused by the nationwide Covid-19 outbreak.

In conclusion on the interpretation of the disease clause, and as the court accepted that the disease clause provided for business interruption caused as a result of the Covid-19 pandemic, and the regulations which were promulgated in response to it, the court found that the Applicants were entitled to the relief which they sought. The ratio of the decision of *Ma-Afrika Hotels (Pty) Ltd and another v Santam Limited and another* (2020), was followed, holding the insurer liable to indemnify the insureds for the loss which they had suffered.

INTERFAX (PTY)LTD & LUGGAGE GLOVE CC v OLD MUTUAL INSURE LTD **[2020] ZAWCHC 166**

Facts

The First Applicant conducted business as a retailer of luxury travel goods in Cape Town at the V&A Waterfront, and had outlets in Kenilworth and Bellville. The Applicants stated that they and small entities which relied on the Applicants, had been significantly impacted by the impact of the lockdown regulations. They contended that they had suffered a substantial loss of gross profit. '…. It is not overstating the issue to state that the impact of this loss with a sustainability of the business and the continued employment of 40 people has been catastrophic'. The Second Applicant withdrew after reaching a settlement with the insurer. The First Applicant had insurance cover under the Business Protection Interruption section of Marsh policy in respect of which the Respondent was the insurer. The Applicant was cover for R17.6 million business interruption policy, which included cover for loss resulting from an

infectious or contagious disease. The Respondent repudiated the claim, which led to the Applicant being forced to approach the High Court for relief.

The Applicant applied to the High Court for a declaratory order stating that the promulgation and the enforcement of the Regulations made in response to the Covid-19 pandemic outbreak, and the consequent interruption of the Applicant's business amount to a defined event for which indemnity is provided. The Applicant sought an order that the Respondent was liable for the losses, calculated according to the loss of gross profit and subject to an indemnity period of 6 months.

The applicable policy wording- Murder, Suicide, Food Poisoning- which was subject to the dispute stated the following:

'Loss resulting from interruption of or interference with the business in consequence of the following events, shall be deemed to be loss resulting from Damage (as defined)–

(a)	murder or suicide food or drink poisoning	))	at the premises of the insured
(b)	vermin, pests or defective sanitary arrangements at the insured's premises	))))))))))	provided that the local, regional, municipal or government authority responsible for the area has declared a notifiable medical condition or communicable disease to exists within the area and/or has imposed quarantine regulations and/or to restrict access to the area in terms of any local, regional, municipal, or
(c)	contagious or infectious diseases at the premises	))	national law or by-law or regulation pertaining to public health and safety

(d)	contagious or infectious diseases within a 50 km radius of the premises	))	
(e)	shark scare	)	
		)	within a 50 km radius of the premises
(f)	oil pollution	)	

[11] There is thus a proviso in respect of paras (b), (c) and (d) of this clause which reads:

> 'Provided that the local, regional, municipal or government authority responsible for the area has declared a notifiable medical condition or communicable diseases to exist within the area and/or has imposed quarantine regulations and/or acted to restrict access to the area in terms of any local, regional, municipal or national law or bye-law or regulating pertaining to public health and safety.'

The Court pointed out that although the record was extensive and the heads of argument were detailed, it narrowed down the issue for determination to the following: whether para(d) of the aforesaid clause together with the provision, supported the granting of the declaratory order as sought by the Applicant. The court in consideration of the Respondent's argument, focused essentially on the following: 'although the disease may be widespread, the clause requires that there be a local occurrence of the defined disease which must cause the business interruption and consequential loss' (paragraph 12). The Respondent's argument which the court narrowed it down to, was that the 'policy does not cover the Applicant where both the disease and the response thereto are national in nature' (paragraph 13).

Decision

Judge Davis quoted extensively from passages of the FCA test case judgment which were relied on to assist with the interpretation of the dispute clause, subject of focus in this case. The court commented on the implications of these passages on the dispute which he was considering. The following implications from the quoted passages of the FCA case were identified as follows:

- the clause, which was relevant in the dispute, required that the disease make a local appearance, that it requires that the local or national authorities intervene, and order that access is restricted thereby imposing restrictions;
- the national response does not have to exclusively regulate access to an area close to the insured's premises, to fall within the scope of the insured peril, and there was no requirement that the government respond to the outbreak by imposing a defined radius from the insured premises (paragraph 28).

As in the previous cases, the court placed much focus on the interpretation of contract. The *Natal Joint Municipal Pension Fund v Endumeni Municipality* case and the *City of Tshwane Municipality v Blair Athol Homeowners Association* case were referred to for the authority that a wider interpretation of the wording of a contract and the proposition that the wording must not be considered in isolation. The wording of a text must not be considered restrictively, and due regard must be given to the context thereof. The wording of the text is 'presented as the basis for a justiciable issue'.

The SCA of *Centriq Insurance Company Ltd v Oosthuizen and another,* was relied upon to support the approach in respect of insurance contracts. The purpose of the contract is imperative in determining the manner of interpretation of the policy to ensure that this would 'yield to a fair and sensible application'. The court at paragraph 33 stated that in the in respect of an insurance contract, the intention of the insured seeking cover would be subject to an assessment of business common sense, and the evaluation of risk by the insurer, when interpreting the wording of the policy.

The SCA found in favour of the insured, and held that it enjoyed cover under the Business Interruption section of its policy. The basis for such decision, was the following:

- the interpretation of the wording of the contract;
- the application of the principles of interpretation to the wording of the policy, on which the court placed much focus; and
- Causation- where the 'but for' principle was considered to determine the proximate of the insured peril. The Applicant was held to have established factual causation between the loss it suffered and the insured peril. In the facts of the case, both factual and legal causation was held to have been established.

Discussion

This decision like the ones that preceded it, referred to the FCA test case policy wordings. The SCA did however clarify that the FCA test case would only be referred to insofar as the facts and the law were applicable to the case to be decided. The judge pointed out "A cautionary observation,…….The use of comparative law to assist in the determination of a dispute should not be an exercise in a jurisprudential Cook's tour. It must focus on whether the dispute before the foreign court and the law applied in the foreign judgment so cited can assist in the application or development of domestic law."

The similarity of the wording of the policy under scrutiny in this case is similar to those considered in the FCA test case. The insurers in the FCA case repudiated the claims on the basis that national lockdown did interrupt the business, but that the lockdown was not the direct response to a specific case of Covid-19 within the radius as defined in the policy. In this SA case, there was a case within the defined insured radius. However the insurer argued that the lockdown was not in response to the local case. But through the argument of causation, the SCA held that there was the causal link between the government reaction and the local case of Covid-19. The court held (paragraph 43):

> "The wording of the policy indicated that there should be an outbreak of the disease within the 50 km radius as defined," Davis wrote. "It also required that the relevant authority restricted access to the area and/or imposed quarantine restrictions. However, nothing in the wording of the policy required that the response of the relevant authority was restricted to dealing exclusively with a local area…."

In *obiter* comments, at paragraph 23 Davis J made the following statement regarding the complexity of the FCA test case and the possibility of confusion which is may cause:

> "I do not propose to engage in a totally unnecessary hermeneutic exposition of the whole judgment but prefer to focus upon that those sections which hold clear relevance to the present dispute. I say this because the judgment is hardly a model of clarity, which is partly the result of complex pleadings instituted by the Financial Conduct Authority, which requested the court to construe a number of wordings of different policies [that] contain non-damage extensions to the standard business interruption cover provided by the relevant insurers."

It is evident that the wording of the policies which are in dispute are imperative in determining the manner of interpretation. This leads to the point that must be noted: the focus of the courts in not only the UK cases, but also the SA cases, was on the wording and the interpretation of the wordings of the policy. No consideration was given to the fundamental principles of business interruption insurance and whether based on those principles, this cover could be provided under BI extensions.

GUARDRISK INSURANCE CO LTD v CAFÉ CHAMELEON CC

(632/20) [2020] ZASCA 173 (17 December 2020)

Facts

The case was and appeal to the SCA from the High Court of the Western Cape, which held upheld an insurance claim by the Respondent arising from the Covid-19 pandemic. Café Chameleon was forced to close its doors during the national government lockdown and as a result of this, had suffered loss to its business. The policy as discussed above, covered the insured ' loss….. resulting in interruption of the business due to notifiable disease occurring within 50km of the premises'. A notifiable disease was defined under the 'special provisions' of the policy as '…..illness sustained by any person resulting from any human infections or human contagious diseases, an outbreak of which the competent local authority has stipulated shall be notified to them…..'.

The central issue which was the subject of the appeal, was whether government's imposition of the lockdown, which was imposed as a result of multiple outbreaks of a 'notifiable disease', predominantly at that time in Cape Town, was covered by the infectious disease clause. Reliance was placed on the FCA test case, the *Ma- Afrika Hotels and another v Santam Ltd* and *Interfax (Pty)ltd and another v Old Mutual* cases.

The SCA considered the following arguments presented by Guardrisk:

- Whether the insured peril included a government response to Covid-19?
- Whether the policy covered the Covid-19 pandemic?
- Whether the insured peril was confined to a localised response to the infectious disease?

The court accepted Café Chameleon's submission that a notifiable disease almost always carries the risk of government intervention, and that accordingly, this was part and parcel of the insured peril. Guardrisk's argument to this submission morphed during this hearing, as it accepted that a local government's response to the outbreak would be part of the insured peril, but that this did not fall within the parameter of the relevant clause. This argument was not accepted by the court.

In respect of the argument whether the policy in fact covered Covid-19, and Guardrisk's contention that because 'the parties had not thought of the risk of a pandemic at the time they contracted (and the policy does not explicitly refer to a pandemic)..' that the insured was not provided indemnity for loss in these circumstances. The court dismissed this argument which

in effect was based on the argument that if a policy provided cover for an earthquake that they realistically expected that an earthquake would occur. The court held that there was no substance to this argument (paragraph 24).

The argument in respect of the third question above which was abandoned by Guardrisk, was that the 'cover is expressly limited only to the particular consequence of a local occurrence of the notifiable disease', and that the cover is not provided in instances where there was a national government response. The court held that the interpretation given to this clause by Guardrisk did not accord ' with a proper construction of the clause' and was rejected.

This lead to a consideration of the issue of causation and causation in insurance. In respect of the question of factual and legal causation, the SCA although acknowledged the simplicity of the approach of the insurer in respect of legal causation. But as the court had determined that the defined event or insured peril was the occurrence of Covid-19 and the response by government with the imposition of the lockdown, the argument was of no effect. At paragraph 51, the court concluded in respect of causation:

> 'Once we accept, as I have, that the government response through the imposition of the lockdown, was both a proximate cause, or as the high court found, sufficiently closely connected to the business interruption and consequent loss, the conclusion that legal causation was proved, follows inevitably'.

Decision

The court comprising of 5 judges dismissed Guardrisk's arguments. Café Chameleon's submissions were accepted, that the business interruption had been caused by both the occurrence of the notifiable disease within the 50km radius and the government's response in the form of the national lockdown. The SCA held that on a fair reading of the policy, cover was provided for both the outbreak and the lockdown.

Discussion

This SCA judgment has set a precedent for cases relating to business interruption insurance in the event of pandemics and national lockdowns. Lower courts are compelled to adhere to it, as well as courts with concurrent and equivalent jurisdiction. Although the decision signifies a significant win for the insured's in the industry, insurers have a lot to reconsider in respect of the existing policy wordings.

ANNEXURE "G" USA CASES

***K.C. Hopps Ltd. v. Cincinnati Insurance Co.*,**

Case No. 4:20-cv-437 (W.D. Mo. 2021).

Facts

The first jury trial which considered the issue of whether Covid-19 business interruption losses were covered was the federal case in the Western District of Missouri. The verdict was issued in favour of the insurer in *K.C. Hopps Ltd. v. Cincinnati Insurance Co.* The insured , KC Hopps Ltd, owned and operated bars, restaurants, offered catering services and event spaces for hire in Kansas City. In March 2020, civil authorities in Missouri and Kansas imposed a lockdown and made stay-at-home orders. KC Hopps' operations were accordingly limited to delivery, drive-through and take-way orders. The insured lodged a claim to the insurer, for losses sustained as a result of this. Indemnity was sought under its commercial property policy for business interruption due to Covid-19. The claim was rejected by Cincinnati Insurance Company. The insured then instituted action against the insurer, under the policy's Business Income, Extra Expense, Civil Authority, and Ingress and Egress coverage provisions.

The policy at issue provided coverage for "the actual loss of 'Business Income' [the insured] sustain[ed] due to the necessary 'suspension' of [the insured's] 'operations' during the 'period of restoration.'" The policy specified that the " 'suspension' must be 'caused by direct 'loss' to property at a 'premises' caused by or resulting from any Covered Cause of Loss." The policy further provided coverage for 'Extra Expense' sustained during the 'period of restoration'. The policy defined 'loss' as 'accidental physical loss or accidental physical damage,' but did not define the terms 'physical loss' or 'physical damage'. The policy defined 'period of restoration' as beginning at the time of direct 'loss' and ending at the time of repair, resumption of business at a new permanent location, or a specified number of months after "direct physical 'loss.'"

The policy's Civil Authority provision provided coverage for business income loss and extra expense 'caused by action of civil authority that prohibits access' to a premises other than covered property, provided that: (a) access to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage; and (b) the

action of civil authority is taken in response to dangerous physical conditions resulting from the damage or to enable the civil authority to have unimpeded access to the damaged property. The Ingress and Egress provision provided coverage for business income loss and extra expense caused by "the prevention of existing ingress or egress at a 'premises' shown in the Declarations due to direct 'loss' by a Covered Cause of Loss at a location contiguous to such 'premises.'"

The insurer argued during the motion for summary judgment, that the insured had failed to demonstrate that Covid-19 had been the cause of physical loss or physical damage to the insured premises. Further, no evidence was presented by Hopps KC that Covid-19 had been present at the premises and it was clear that the premises had been operational throughout the relevant time. Finally, there was no evidence that Covid-19 had impacted on the premises making the premises unsafe for use. The argument submitted by the insurer was that Hopps KC had not sustained 'actual loss' as was the requirement to prove Business Income coverage, it was also not entitled to Civil Authority coverage or Ingress and Engress coverage. Certain policy exclusions which were included in the policy, excluded certain coverage.

Decision

Summary judgement was granted in favour of the insurer, granting Civil Authority coverage and Ingress and Egress coverage. Summary judgement was not granted on whether business Income coverage was triggered. The lockdown orders, although limiting the insured's operations, did not prevent access to the insured's premises, and it was on this basis that the court found in favour of the insurer. KC Hopps argued that it had sustained 'physical loss' or 'physical damage', which had been caused by the government lockdown orders, which argument was rejected by the court. The insurer's argument that physical contamination at the insured's premises could never satisfy the requirements of 'physical loss' or 'physical damage, wad also rejected by the court. The court found that physical contamination of the insured premises, would in fact render the premises unsafe, and as such, would amount to 'physical loss' or 'physical damage'.

The court held further that there was sufficient evidence presented by KC Hopps, which supported the inference that SARS-CoV-2 was in fact present at the insured premises and that this rendered the property unsafe. This was the trigger for coverage, and supported

the decision to approach the court for relief. The inference that the insured's operations were reduced in order to limit the spread of Covid-19 on the insured premises, was supported by the record. It was stated that the mere fact that the use of the premises were reduced and still had the reduced capacity to operate, did not preclude coverage. A genuine question of fact was raised on the point whether the insured had suffered 'actual loss' of income, which was the trigger that was required to trigger the coverage of the Business Income clause.

The court ultimately found in favour of the insurer on all the claims. It is evident that the jury did not find in favour of KC Hopps, on the argument that the business interruption losses had resulted from the lockdown orders and which amounted to 'physical loss' or 'physical damage' to the insured property, and which there triggered cover under the policy.

Discussion

The KC Hopps case, it was the first case where the jury agreed with the previous summary judgments or motion matters, where the approach of the courts was that business losses resulting from the Covid-19 government lockdown, did not amount to 'physical loss' or 'physical damage' to the insured property. This has been the approach of the USA courts in cases which followed the KC Hopps case.

OTHER US CASES

In total nearly 2000 cases were filed in the US in all of its states. These involved the main policy and some extensions to the policy. The US policies did not include the non-material damage extensions and thus the litigation was different, Since the fundamental feature of the business interruption policy is material damage to the insured property generally the US cases have been dismissed without going to trial. There is no point for the purposes of this dissertation to discuss these cases any further.

ANNEXURE “H” THE MULTIMARK POLICY

ANNEXURE "I" *FA NEWS PUBLICATIONS*

ANNEXURE "J" THE FINAL *FA NEWS* PUBLICATION NOVEMBER 2022

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MUTUAL&FEDERAL

BUSINESS INTERRUPTION SECTION

Defined events

Loss following interruption of or interference with the business in consequence of damage occurring during the period of insurance at the premises in respect of which payment has been made or liability admitted under:

(i) the fire section of this policy

(ii) the buildings combined section of this policy

(iii) the office contents section of this policy

(iv) any other material damage insurance covering the interest of the insured

but only in respect of perils insured under the fire section hereof (hereinafter termed Damage).

Liability shall be deemed to have been admitted if such payment is precluded solely because the insured is required to bear the first portion of the loss.

The company will indemnify the insured in accordance with the provisions of the specification hereinafter set out.

Specific conditions

1. The insurance under this section shall cease if the business is wound up or carried on by a liquidator or judicial manager or is permanently discontinued, except with the written agreement of the company.
2. On the happening of any Damage in consequence of which a claim may be made under this section, the insured shall, in addition to complying with general conditions 6 and 7, with due diligence do and concur in doing and permit to be done all things which may be reasonably practicable to minimise or check any interruption of or interference with the business or to avoid or diminish the loss, and in the event of a claim being made under this section shall, not later than 30 days after the expiry of the indemnity period, or within such further time as the company may in writing allow, at their own expense deliver to the company in writing a statement setting forth particulars of their claim together with details of all other insurance covering the loss or any part of it or consequential loss of any kind resulting therefrom. No claim under this section shall be payable unless the terms of this specific condition have been complied with and, in the event of non-compliance therewith in any respect, any payment on account of the claim already made shall be repaid to the company forthwith.

Item 1 Gross profit (difference basis)

The insurance under this item is limited to loss of gross profit due to

(a) **reduction in turnover** and

(b) **increase in cost of working**

and the amount payable as indemnity hereunder shall be

(a) **in respect of reduction in turnover** the sum produced by applying the rate of gross profit to the amount by which the turnover during the indemnity period shall, in consequence of the Damage, fall short of the standard turnover

(b) **in respect of increase in cost of working** the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in turnover which, but for that expenditure, would have taken place during the indemnity period in consequence of the Damage, but not exceeding the sum produced by applying the rate of gross profit to the amount of the reduction thereby avoided

less any sum saved during the indemnity period in respect of such of the charges and expenses of the business payable out of gross profit as may cease or be reduced in consequence of the Damage, provided that the amount payable shall be proportionately reduced if the sum insured in respect of gross profit is less than the sum produced by applying the rate of gross profit to the annual turnover where the maximum indemnity period is 12 months or less, or the appropriate multiple of the annual turnover where the maximum indemnity period exceeds 12 months.

Item 1 Gross profit (additions basis)

The insurance under this item is limited to loss of gross profit due to

(a) **reduction in turnover** and

(b) **increase in cost of working**

and the amount payable as indemnity hereunder shall be

(a) **in respect of reduction in turnover** the sum produced by applying the rate of gross profit to the amount by which the turnover during the indemnity period shall, in consequence of the Damage, fall short of the standard turnover

(b) **in respect of increase in cost of working** the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in turnover which, but for that expenditure, would have taken place during the indemnity period in consequence of the Damage, but not exceeding the sum produced by applying the rate of gross profit to the amount of the reduction thereby avoided

less any sum saved during the indemnity period in respect of such of the insured standing charges as may cease or be reduced in consequence of the Damage, provided that the amount payable shall be proportionately reduced if the

sum insured in respect of gross profit is less than the sum produced by applying the rate of gross profit to the annual turnover where the maximum indemnity period is 12 months or less, or the appropriate multiple of the annual turnover where the maximum indemnity period exceeds 12 months.

Memo

If any standing charges of the business are not insured under this section, then in computing the amount recoverable hereunder as increase in cost of working, that proportion only of the additional expenditure shall be brought into account which the sum of the net profit and the insured standing charges bears to the sum of the net profit and all the standing charges.

Item 2 Gross rentals

The insurance under this item is limited to

(a) **loss of gross rentals** and

(b) **increase in cost of working**

and the amount payable as indemnity hereunder shall be

(a) **in respect of loss of gross rentals** the amount by which the gross rentals during the indemnity period shall in consequence of the Damage fall short of the standard gross rentals

(b) **in respect of increase in cost of working** the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of gross rentals which, but for that expenditure, would have taken place during the indemnity period in consequence of the Damage, but not exceeding the amount of the loss of gross rentals thereby avoided

less any sum saved during the indemnity period in respect of such of the charges and expenses of the business payable out of gross rentals as may cease or be reduced in consequence of the Damage, provided that the amount payable shall be proportionately reduced if the sum insured in respect of gross rentals is less than the annual gross rentals where the maximum indemnity period is 12 months or less, or the appropriate multiple of the annual gross rentals where the maximum indemnity period exceeds 12 months.

Item 3 Revenue

The insurance under this item is limited to

(a) **loss of revenue** and

(b) **increase in cost of working**

and the amount payable as indemnity hereunder shall be

(a) **in respect of loss of revenue** the amount by which the revenue during the indemnity period shall, in consequence of the Damage, fall short of the standard revenue

(b) **in respect of increase in cost of working** the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the loss of revenue which, but for that expenditure, would have taken place during the indemnity period in consequence of the Damage, but not exceeding the amount of loss of revenue thereby avoided

less any sum saved during the indemnity period in respect of such of the charges and expenses of the business payable out of revenue as may cease or be reduced in consequence of the Damage, provided that the amount payable shall be proportionately reduced if the sum insured in respect of revenue is less than the annual revenue where the maximum indemnity period is 12 months or less, or the appropriate multiple of the annual revenue where the maximum indemnity period exceeds 12 months.

Item 4 Additional increase in cost of working

The insurance under this item is limited to reasonable additional expenditure (not recoverable under other items) incurred with the consent of the company during the indemnity period in consequence of the Damage for the purpose of maintaining the normal operation of the business.

Item 5 Wages (Number of weeks basis)

The insurance under this item is limited to the loss incurred by the insured by the payment of wages for a period beginning with the occurrence of the Damage and ending not later thereafter than the specified number of weeks.

The amount payable as indemnity under this item will be the actual amount which the insured shall pay as wages for such period to employees whose services cannot, in consequence of the Damage, be utilised by the insured at all and an equitable part of the wages paid for such period to employees whose services cannot, in consequence of the Damage, be utilised by the insured to the full

provided that if the sum insured by this item is less than the aggregate amount of the wages that would have been paid during the specified number of weeks immediately following the Damage had the Damage not occurred, the amount payable will be proportionately reduced.

Standard turnover

Standard revenue

Standard gross rentals The turnover (revenue) (gross rentals) during that period in the twelve months immediately before the date of the Damage which corresponds with the indemnity period

of such sales or services shall be brought into account in arriving at the turnover, revenue or gross rentals, during the indemnity period.

Extensions and clauses

Accountants clause

Any particulars or details contained in the insured's books of account or other business books or documents which may be required by the company under this section for the purpose of investigating or verifying any claim hereunder, may be produced and certified by the insured's auditors or professional accountants, and their certificate shall be prima facie evidence of the particulars and details to which it relates.

Accumulated stocks clause

In adjusting any loss, account shall be taken and an equitable allowance made if any shortage in turnover or revenue due to the Damage is postponed by reason of the turnover or revenue being temporarily maintained from accumulated stocks.

Departmental clause

If the business is conducted in departments or branches, the independent trading results of which are ascertainable, the provisions under items 1 (gross profit), 2 (gross rentals) or 3 (revenue) relating to reduction in turnover/gross rentals/revenue and increase in cost of working, shall apply separately to each department or branch affected by the Damage, except that if the sum insured by the relative item is less than the aggregate of the (annual gross rentals) (annual revenue) (sums produced by applying the rate of gross profit) for each department or branch, whether or not affected by the Damage, (to the relative annual turnover thereof) (proportionately increased if the number of months referred to in the definition of indemnity period exceeds twelve), the amount payable shall be proportionately reduced.

Deposit premium clause

In consideration of the premium by items 1, 2 or 3 being provisional in that it is calculated on 75 per cent of the sum insured, the premium is subject to adjustment on expiry of each period of insurance as follows

In the event of the gross profit/gross rentals/revenue earned (proportionately increased if the number of months referred to in the definition of indemnity period exceeds twelve) during the financial year most nearly concurrent with any period of insurance being less or greater than 75 per cent of the sum insured thereon, a pro rata return or additional premium not exceeding $33^1/_3$ per cent of the provisional premium paid for such period of insurance will be made in respect of the difference.

In the event of a claim being made under this section, the amount paid or payable thereon shall be regarded as actually earned.

Output (alternative basis) clause

At the option of the insured, the term output may be substituted for the term turnover and, for the purposes of this section, output shall mean the sale or transfer value, as shown in the insured's books, of goods manufactured or processed by the insured at the premises

provided that

(a) only the meaning of output or the meaning of turnover shall be operative in connection with any one event resulting in interruption

(b) if the meaning of output be used

  (i) the accumulated stocks clause shall be inoperative

  (ii) the memo at the end of the definitions shall read

If, during the indemnity period, goods shall be manufactured or processed other than at the premises for the benefit of the business either by the insured or by others on behalf of the insured, the sale or transfer of such goods shall be brought into account in arriving at the output during the indemnity period.

Salvage sale clause

If the insured shall hold a salvage sale during the indemnity period clause (a) of item 1 (gross profit) shall, for the purposes of such claim, read as follows

(a) **in respect of reduction in turnover** the sum produced by applying the rate of gross profit to the amount by which the turnover during the indemnity period (less the turnover for the period of the salvage sale) shall, in consequence of the Damage, fall short of the standard turnover, from which sum shall be deducted the gross profit actually earned during the period of the salvage sale.

Extensions to other premises

Loss as insured by this section resulting from interruption of or interference with the business in consequence of Damage (as within defined) at the undernoted situations or to property as undernoted shall be deemed to be loss resulting from Damage to property used by the insured at the premises.

(a) Specified suppliers/sub-contractors (if stated in the schedule to be included)

The premises of the suppliers and sub-contractors specified in the schedule subject to stated limits

(b) Unspecified suppliers (if stated in the schedule to be included)

the premises of any other of the insured's suppliers, manufacturers or processors of components, goods or materials, but excluding the premises of any public supply undertaking from which the insured obtains electricity, gas or water subject to the limit stated in the schedule

(c) Storage, transit and vehicle

property of the insured whilst stored or whilst in transit by air, road, rail or inland waterway or being motor vehicles of the insured elsewhere than at premises in the occupation of the insured

(d) Contract sites

any situation not in the occupation of the insured where the insured are carrying out a contract

(e) Prevention of access

property within a 10 km radius of the insured's premises, destruction of or damage to which shall prevent or hinder the use of the premises or access thereto, whether the premises or property of the insured therein shall be damaged or not

(f) Prevention of access - extended cover (if stated in the schedule to be included)

property within a 10km radius of the premises, destruction of or damage to which shall prevent or hinder the use of the premises or access thereto, whether the premises or property of the insured therein shall be damaged or not

(g) Additional premises

in the event of the insured occupying or having property at any newly added premises for the purpose of the business during the currency of this section, such newly added premises shall be deemed to be included in those specified here subject to notification to the company as soon as reasonably practicable and to adjustment of the premium if necessary

(h) Customers (if stated in the schedule to be included)

the premises of the customers specified in the schedule subject to stated limits

(i) Public utilities - insured perils only (if stated in the schedule to be included)

property at electricity generating stations, sub-stations or transmission networks, gas-works including the related gas distribution network, water purification plants, pumping stations, aqueducts and pipelines of an authority empowered by law to supply water, gas or electricity for consumption by the public and which results in an interruption of water, gas or electricity to the premises of the insured.

(j) Public telecommunications - insured perils only (if stated in the schedule to be included)

(i) property at the premises of any public authority which is empowered by law to supply a telecommunications facility to the insured

(ii) the transmission facilities network of the public authority mentioned in (i).

Public telecommunications - extended cover (if stated in the schedule to be included)

Loss as insured resulting from interruption of or interference with the business in consequence of the failure of the public telecommunication facilities to the premises of the insured shall be deemed to have resulted from Damage (as within defined) provided this extension does not cover loss resulting from damage directly or indirectly caused by:

(i) drought

(ii) a fault on any part of the premises belonging to the insured

(iii) a decision by any authority to legally withhold the telecommunication facility from the insured unless such decision is directly attributable to Damage to property of such authority

(iv) any event described in general exception 1 and 2 but cover provided under the Malicious damage extension in the underlying policy is not excluded.

If the failure of the facility is due to its mechanical or electrical or electronic breakdown, there shall be no liability under this extension unless the interruption or interference with the business of the insured extends beyond 24 hours.

Public utilities - extended cover (if stated in the schedule to be included)

Loss as insured resulting from interruption of or interference with the business in consequence of total or partial failure of the public supply of water, gas or electricity to the premises of the insured shall be deemed to have resulted

from Damage (as within defined) provided that this section does not cover loss resulting from damage directly or indirectly caused by-

(i) drought

(ii) pollution of water

(iii) shortage of fuel or water

(iv) a fault on any part of the installation belonging to the premises

(v) the exercise of an authority empowered by law to supply water, gas or electricity of its power to withhold or restrict supply unless such withholding or restriction is directly attributable to Damage to property of such authority

(vi) any event described in General exception 1 and 2 but cover provided by the Malicious damage extension in the underlying material damage section of this policy is not excluded.

In respect of interruption of or interference with the business arising from mechanical or electrical or electronic breakdown, there shall be no liability under this extension for interruption of or interference with the business unless such interruption or interference extends beyond 24 hours from commencement thereof.

The geographical limits of

(b), (c), (d), (e), (f), (h), (i) and (j) of the extensions to other premises and the extended covers for public telecommunications and public utilities are confined to the Republic of South Africa, Namibia, Botswana, Lesotho, Swaziland, Zimbabwe and Malawi.

(g) of the extensions to other premises is confined to the Republic of South Africa and Namibia.

Accidental damage (if stated in the schedule to be included)

The following defined event is added:

"Loss following interruption or interference with the business in consequence of damage occurring during the period of insurance at the premises in respect of which payment has been made or liability admitted under defined event (i) of the Accidental damage section of this policy (hereinafter termed Damage) provided that:

(a) the provision under any item of this section that the payment will be reduced proportionately if the amount insured by the item is not adequate, is deleted in respect of this defined event

(b) the company shall not pay more than the sum insured stated in the schedule of the Accidental damage section for both this section and the Accidental damage section combined.

Policy No:
Transaction No:
Effective Date:

Insured:

Section Business Interruption

Details		Sum Insured
Premises _		R
Item 1 Gross profit (_ basis)		_ _ _ _ _ _
Item 2 Gross rentals		_ _ _ _ _ _
Item 3 Revenue		_ _ _ _ _ _
Item 4 Additional increase in cost of working		_ _ _ _ _ _
Item 5 Wages (No of weeks basis) No of weeks _ _ _ _		_ _ _ _ _ _
Item 6 Fines and Penalties		_ _ _ _ _ _
Indemnity period: a maximum of _ _ _ months		
Definitions (indicate Yes/No as applicable)	**Included**	
Uninsured costs (difference basis).....	_ _	
_ _		
Insured standing charges (additions basis).....	_ _	
_ _		
Extensions and Clauses		
Suppliers/Subcontractors (specified).....	_ _	_ _% of the insured by items 1 to 5
Suppliers/Subcontractors (unspecified).....	_ _	_ _% of the insured by items 1 to 5
Prevention of access - Extended cover.....	_ _	
Customers (specified).....	_ _	_ _% of the insured by items 1 to 5
Public utilities - insured perils.....	_ _	
Public telecommunications - insured perils.....	_ _	
Public telecommunications - extended cover.....	_ _	
Public utilities - extended cover.....	_ _	
Accidental damage (subject to a combined Business Interruption / Accidental Damage limit as specified in the Accidental Damage section)	_ _	as specified in Accidental Damage section
Additional claims preparation costs	_ _	_ _ _ _ _ _

RELYING ON LABELS... NOT GOOD ENOUGH



▶ IN PERSPECTIVE WITH PROF VIVIAN ▶▶▶

Business interruption (BI) insurance has received a great deal of attention. However, it should be clear that this class of insurance is not well understood.

The purpose of this series of articles is to explain it, so it can be understood. To do this, it is necessary to start at the beginning; the origins of business interruption insurance.

Labels can be misleading

To communicate, we assign labels to everything. So, one can say, "I had a cup of coffee and toast for breakfast". Cup, coffee, cup of coffee, toast and breakfast are all labels which convey ideas. Labels generally are descriptions, not definitions. However, one should be careful not to be misled by the mere ideas' labels may convey. Take the following statement for example. "I purchased business interruption insurance cover, which specifically contains a contagious disease extension."

Logically, the person who makes this statement could conclude any business interruption loss which the business sustains because of COVID-19, is covered. The labels used will lead to that conclusion. Once that conclusion is reached, others naturally follow, with statements such as, "Insurers are evil because they repudiated my business interruption claim."

The problem is one cannot rely merely on labels. Doing so, leads to wrong conclusions. The policy itself must be understood. In this regard it is important to understand that property damage insurance policies do not cover consequential losses; nor do they cover legal liability claims.

Different heads of damage

For a long time, it has been understood that when a loss event occurs, different heads of damages could arise.

So, in the ***Roman Digest,*** Paul the jurist - when discussing what a wrongdoer should be liable for when causing damage or injury - noted, "Furthermore, other heads of damage necessarily connected [to the damage itself] are taken into account." He then went on to give a few examples and concluded " ...not only must a valuation be made of the object destroyed [property loss], but it must also be borne in mind how much the value of the others had been lessened".

There are at least four different heads of damage:

1. Those associated with the object itself,
2. Consequential losses arising out of the loss or damage to the object,
3. Legal liability claims arising out of an event and
4. Pure financial losses.

Cover provided by property insurance

Property loss or damage insurance started with marine, then fire, followed by accident insurance.

So, two simple questions need to be posed and answered. Firstly, does property insurance cover consequential losses, and secondly, does property damage insurance cover legal liability claims?

■ Marine

The courts have always insisted any payment made by insurers is limited by indemnity. It can be argued that consequential losses are a natural consequence of the loss event. In this way, it could be argued both consequential losses and legal liability claims are covered by the concept of indemnity. Marine insurance evolved over the centuries, with the fundamental perils being "perils of the sea", which is not very clear. With both the concepts of indemnity and perils being vague, a plausible argument can be made that both consequential losses and legal liability claims are covered by the marine property damage policy.

The English Court considered the matter in the case of *De Vaux versus Salvador, 1836.* The insured vessel had collied with another, and two heads of damage were presented to the court to consider. The first was for wages being paid while the vessel was being repaired, and the second was for the damages sustained by the other vessel. The first is a form of consequential losses and the second is a legal liability claim. The English court dismissed both. So, it was settled. Marine insurance does not cover consequential losses or legal liability claims. It is not that these heads of damages are uninsurable, but they were not insured in terms of insurance, which indemnifies for the loss or damage to property.

There seems to be some confusion about the De Vaux case. The peril was a collision. The property damage was impact damage to the property. Some have argued, and still do, that a collision is a "peril of the sea". There are in fact two separate issues involved: firstly, what is the peril, and secondly, what are the heads of the damage being claimed. After the De Vaux case, the marine hull policy was amended to give a measure of cover, still based on the value of the insured hull. The rest could be and is insured elsewhere.

■ Fire

The same issue arose, a bit earlier, concerning fire insurance. In the *Wright versus Pole case, 1834,* an inn was destroyed by fire. The insured tried to recover the loss of profits and increased cost of working in the form of the leasing costs for another premises. Both are forms of consequential losses. The court rejected both heads. A further unsuccessful attempt was made to recover consequential

losses in the case of *Menzies versus North British and Mercantile Insurance Company Ltd, 1847*. Thus, it became clear fire property damage insurance does not cover consequential losses.

■ **Accident insurance**

The next market to develop was the accident market. An attempt was made to recover loss of profits in terms of an accident policy in the *Theobald versus Railway Passengers' Assurance Company case, 1854*, with the same outcome; no success.

So, it can be concluded that indemnification in terms of property insurance indemnifies against property losses, and not consequential losses or legal liability claims.

Practical reality

Property is exposed to a variety of perils, fire being an example. The peril operates to bring about an accidental event resulting in accidental loss or damage to the property. The property damage policy indemnifies against the property damage but not consequential losses or liability claims. The insured is thus exposed to losses not covered by the property damage policy. These are not uninsurable risks, but are not insured by property insurance. To cover those losses, further policies are is needed - a consequential loss policy for consequential losses.

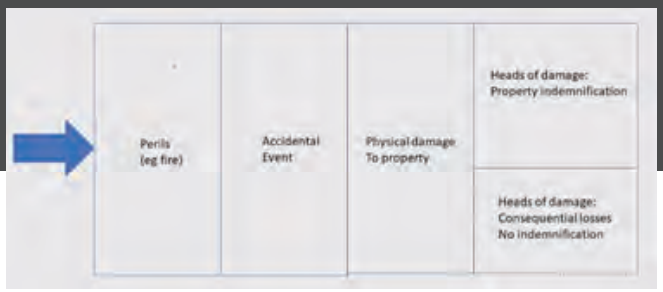

Figure 1: *Scope of cover of property damage insurance; does not cover consequential losses.*

Back to labels

The BI policy has, in its history, had several labels. Probably the most appropriate label is the consequential loss policy. This conveys a great deal of meaning to the lawyer, but less to the insured. Business interruption conveys more to the insured, which is fine, if what it means is understood. By itself, the label is misleading.

Practical approach

To understand what happens working from the heads of damage backwords makes matters clearer - an insured experiences a reduction in revenue; the consequential loss; this is because the revenue producing property was not available to produce the revenue because it was subject to direct physical loss, harm or damage when an insured event occurred caused by an insured peril; or for which the insured is indemnified in terms of the property damage policy.

Clearly, the consequential insurance policy is a policy augmenting the property damage cover. It provides the consequential loss indemnification not provided by the property damage policy. Seen in this light, the risk facing the insured is the unavailability of the revenue producing property, since that has been physically lost or damaged.

It is also important to realise that the problem of consequential losses became clear in the 1850s, nearly 180 years ago, and the practical way of insuring consequential losses, the solution to provide insurance cover, was implemented in 1899, 120 years ago. Understanding that all of this happened a long ago assists to understand why this class of insurance is not well-understood.

In the next article we will look at the fundamental principles on which the consequential loss policy is based. ●


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FUNDAMENTAL PRINCIPLES OF CONSEQUENTIAL LOSSES

▶ IN PERSPECTIVE WITH PROF VIVIAN ▶▶▶

In the previous article, we pointed out that property insurance does not cover consequential losses. Consequential losses are, however, insurable.

To be insured, property cover must be augmented by a separate insurance policy, the consequential loss policy. The purpose of this article is to set out the fundamental principles of consequential losses.

Consequential loss indemnification

What happens in practice, when a loss occurs, is the following: an insured suffers a reduction in revenue (shortage in turnover) over a specified period, compared to the expected turnover during the same period. This is because the insured revenue producing property was not available to produce the revenue. This was because the property was subject to a physical loss or damage. This property was insured in terms of a property damage policy. Indemnification against the physical loss, or damage, is in terms of the property damage policy. There is no indemnification against consequential losses in terms of the property damage policy. The consequential loss policy covers the consequential losses.

Since consequential loss indemnification augments the property damage cover, this indemnification is only recoverable if indemnification for property loss is payable.

The consequential loss policy is not a free-standing policy. If it were, it would then cover pure financial losses, which is not what it is designed to be .

Terms from terminology

With respect to the question of insurability, the consequential loss cover is linked to the damage of the property, which is a specific event. Loss of income, which is not related to the damage to the property, could be a systemic risk which is uninsurable.

The source of the revenue or turnover shortage is the unavailability of the revenue producing property, not the insured peril. As Sir Francis Bacon correctly pointed out: to the cause of causes, there is no end, thus we need to content ourselves with the proximate cause, not the remote cause. For the consequential loss policy, the proximate cause (peril) is the unavailability of the insured property, and the remote peril is the peril which damaged the property. For the property damage policy, the proximate cause (peril) is the cause which damaged the insured property.

The consequential loss policy was designed about 120 years ago, and it expressed ideas using the terminology of that age. The terminology is still valid today, but there is a tendency nowadays to introduce different terminology, which can be confusing.

We can use one of several terms (terminology). It can be said that the insured suffered a loss of income, or revenue or turnover, instead of saying the insured suffered a shortage of turnover. And, instead of saying shortage, for example, one could say reduction.

To make matters worse, there is a tendency to construct and write policies in what is now called plain English, which is yet another set of words trying to say the same thing. This wide range of words can create confusion. To explain the principles, we will stick to old fashion words.

Measure of consequential loss

During any period, the insured expects to produce a turnover, say T. The insured will expend an amount of E, to produce the turnover. Out of the turnover, the insured expects to earn a profit of P. Thus: T = E + P.

Expenses can be separated into two categories, variable (V) or standing charges (S). For example, the insured may be a seller of imported goods. Goods are bought and sold. The more goods sold, the greater the turnover, the fewer goods sold, the lower the turnover. In this case, the goods will be classified as variable expenses. On the other hand, the insured may have borrowed money, on which interest is payable without or without production.

The interest payment could, thus, be regarded as a standing charge. In determining the indemnity arising out of the unavail ability of the insured property, it can therefore be said that: T = V + S + P.

If production ceases, then V, as an expense, is not incurred. But, if the insured property is unavailable to produce the turnover, the insured would still incur the S, and would not earn the P. Accordingly, the measure of the consequential loss would be S + P. This is what forms the basis of the consequential loss indemnification. It is referred to as the Insured Gross Profit.

Other methods include:

This leads to the additions method: Insured Gross Profit = S + P
The above equation leads to the differences method: T – V = S + P
Or: Insured Gross Profit = T – V.

Of course, the shortage of turnover will seldom equal the expected turnover. The period of loss seldom coincides with the indemnity period. The loss of production is seldom total, it may be partial. To deal with this, it must be realised that:
T/T=100= V/T+((S+P))/T.



The above equation indicates that a percentage of the turnover produces the Insured Gross Profit. The ratio (S + P)/T is the Rate of Insured Gross Profit. So, for example, it can be that an insured, uses say 60 per cent of the turnover to cover variable charges then 40 per cent covers the Insured Gross Profit.

Now, it should be clear how the fundamental principles of consequential loss insurance works. After a loss, the estimated turnover for the indemnity period is determined. The actual turnover can be determined from the accounts. The difference between the two, the shortage of turnover which thus can be determined. The rate of Insured Gross Profit can be applied to the shortage, and the indemnity figure thus is established.

Increase in cost of working

Of course, when an insured event occurs, many practical problems are experienced. For example, a company may have two manufacturing plants, and one is damaged by fire, but the other is not. Say, the one in Gauteng is damaged, and the one in the Cape is not. The insured works out that if the Cape plant works 24 hours a day, the loss of production can be covered. To achieve this, staff from Gauteng are temporality relocated to the Cape, and the increased Cape production is transported to Gauteng. All of this results in an increase in costs of working, but on the other hand, there is no loss or shortage of turnover.

The increased costs of working results in no loss of Insured Gross Profit, since there is no loss or shortage of turnover. However, to achieve the maintenance of turnover, the insured incurred increased costs - had the costs not been covered, this would have resulted in lower profits.

Thus, in this case, to ensure indemnification, the consequential loss policy would have to cover increased cost of working.

Other matters

In practice, consequential losses can be very complex, but what is needed is a single policy which will covers every possible eventuality. It would be impractical to have dozens of different policies, which cover different eventualities. From a practical perspective, the basic policy which responded to COVID-19, was designed 120 years ago, and has worked extremely well ever since. The developments which have taken place, and will be discussed in a subsequent article, involve extensions to the policy.

This is important in South Africa and the UK, since this litigation involved extensions to the basic policy. However, it does not appear to be as important in the US, where litigation has involved the basic policy.

The application of consequential loss insurance requires a great deal of knowledge and dexterity in accounting. This is the position in placing the cover, and particularly the position when it comes to claims. In practice, as a rule, consequential loss insurance has shifted largely to the accounting domain, with insufficient attention being paid to the fundamental principles.

It is equally unfortunate that in approaching consequential loss insurance problems, too much effort has been directed at general insurance principles, and insufficient attention has been paid to the general principles applicable to the consequential loss policy itself.



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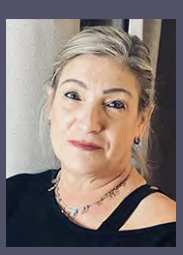

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ATTEMPTS TO DESIGN A CONSEQUENTIAL

In the first article, we pointed out that when a property loss occurs, in addition to the property damage costs, consequential losses that arise are not indemnified in terms of the property damage cover.

In the second article, we set out the fundamental principles involved, to determine the amount needed to provide indemnification against consequential losses.

In this article, we set out the attempts which were made to provide consequential loss cover.

From a practical perspective, it should be realised that the basic policy which responded to COVID-19 was a general policy, designed 120 years ago, and has worked extremely well ever since. In South African, and the UK, the issue revolved around extension to the basic policy. This will be discussed in a later article.

Early attempts

The realisation that Business Interruption (BI) losses occurred, and these could be insured, emerged in the 18th century.

The first attempt to provide cover was in 1797, by Minerva Universal, a UK insurer which introduced a policy to cover interest payments. Clearly, interest payments are one of the many forms of standing charges. It is important to note that this occurred long before the courts clarified the position that property insurance does not cover consequential losses. The absence of standard accounting practices was the main reason why this policy did not catch on.

Also, it provided very limited cover, covering only one form of standing charges and did not cover loss of profits. In 1817, the English Hamburg Fire Office began to offer loss of rental income insurance, as an extension to its fire insurance policy. Loss of rental income leads to a shortage of turnover.

In 1821, a Time Loss policy was introduced in the UK, also known as the per diem (per day) system, paying a fixed sum based on a daily or weekly rate. This system was conceptually an inadequate type of a valued policy. The possibility of providing consequential loss cover was held back by the absence of uniform accounting standards. This deficiency moved towards a solution, with the formation of the Edinburgh Society of Accountants (formed in 1854), the Glasgow Institute of Accountants and Actuaries (formed in 1854) and the Aberdeen Society of Accountants (formed in 1867), as uniform accounting standards began to emerge.

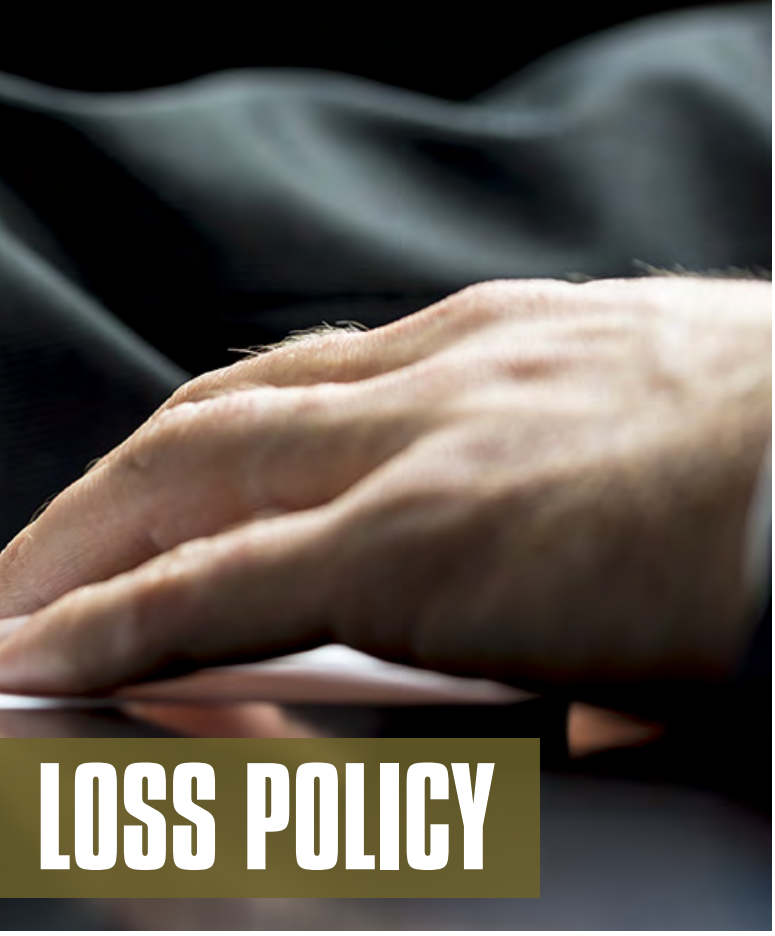
In France, in 1854, the Alsace introduced cover known as "Chômage" insurance. The payment was a fixed amount, expressed as a percentage of the asset's value. This, again, was an inadequate form of a valued policy. This concept was also introduced by some insurers in the UK, in 1868.

In the USA, in 1880, Dalton introduced "use and occupancy" insurance, as a form of business interruption insurance. The policy would pay, upon a loss, a per diem which is different for different periods of the year. These policies limited the payment to the "actual loss sustained".

The great breakthrough

The great breakthrough came in 1899. It therefore took more than a century to design a workable consequential loss policy, and five decades after the courts had made it clear that property insurance does not cover consequential losses.

Credit is given to Ludovic MacLellan Mann (1869-1955), a broker from Glasgow, Scotland, for the development of the currently used consequential loss policy.



LOSS POLICY

This policy was used for four decades before being formally adopted, in 1939, by the British insurance market, as the loss of profits policy. This new form of cover was marketed by the Western Assurance Company. Unlike earlier policies, it used turnover as the basis for the calculation of cover. This covered loss of profits, standing charges and the increase in the cost of working. And thus, the modern consequential loss policy was born.

The contribution of MacLellan Mann, to society, was recently re-discovered, and there is now even a society established in his honour. One would think he would be remembered for the insurance policy he designed, which is still in use today, but this is not even listed in his achievements. He is remembered for other things.

The development of the BI policy

In 1910, the regulatory authority in Germany, following machinery breakdown, approved business interruption insurance. This was followed in 1938, by the Gross Earning Policy, introduced in the USA. This was a form of business interruption insurance, which covered an insured's loss of gross earnings suffered, because of a disruption caused by physical damage. This still did not provide an adequate solution to the financial loss suffered, as a result of the operations of the business being interrupted.

In 1939, in addition to formally adopting the modern BI policy, the additions method was introduced, as an alternative to the original 'difference method' for calculating the insured gross profit. Business interruption insurance was further developed at Lloyd's, by Cuthbert Heath. He designed a product that would bridge the gap between traditional fire insurance and business interruption insurance. His product was criticised, on the basis that the policy was opening up an avenue for fraud, as the loss suffered by the insured could not be quantified with certainty.

Different names have been used to describe this form of cover, including Consequential Loss Insurance, Gross Profits, Business Interruption Cover, Gross Earnings, or Business Income. These policies are indemnity policies and are aimed at compensating the insured for actual financial loss. However, what is important to note, is that all of these policies responded to financial losses originating from actual physical loss to the insured property. The demand for more comprehensive and broader cover grew, as the basic cover was widened, by introducing extensions which will be discussed separately.

In order to provide a workable form of cover, standardised, accurate and reliable books of account needed to be maintained by the insured business. These necessary standards were only introduced by accounting and business bodies in the early 20th century. International standards ensuring accurate and transparent reporting are still continuously being developed.

Cover for 'pure' pandemic risk

It should be clear that the basic BI policy covers consequential losses, which arise out of physical damage to property. This is not what happened with COVID-19. Insurance properties were not damaged. The business losses occurred because the economy was shut down; losses unrelated to physical damage are referred to as pure financial losses. Consequential loss policies are not pure financial loss policies. Thus, a generally usable 'pure' pandemic risk policy has not yet been developed. The main reason for this is that the pandemic risk violates the fundamental principle of insurability.

There have been some attempts to create a pandemic policy. After the Ebola outbreak of 2014-2016, in 2018, Marsh LLC, in association with Munich Re and Metabiotica, marketed a product called PathogenRX, which is the best-known example of a product designed to cover pure pandemic risk. Only one policy of this type was sold pre-COVID-19. The policy was originally designed to cover epidemics but was further developed to cover the pandemic risk. The initial target client base for this cover was the travel or hospitality industry.

Originally, the policy was modelled on morbidity and mortality tables, and aimed to cover events which would not result in death, but which would probably impact on a person's ability to travel between areas, or which would result in international borders being closed. New triggers involved restrictions and regulations by governments involving lockdowns, supported by evidence that loss was suffered by the insured. The policy can be tailored to individual requirements, to provide cover for various geographical areas, specific expenses, types of diseases or specific periods of time.

In the next part of this series (February 2022 edition), we will look at how the fundamental principles are captured by the policy wording.



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THE BUSINESS INTERRUPTION POLICY: CAPTURING CONSEQUENTIAL LOSSES

In the first article, we pointed out that property damage policies indemnify against loss or damage to the property only.

In the second article, we set out the principles which allow the insured to be indemnified against consequential losses. In the third article, we set out the history of attempts to provide such cover.

In this article, we discuss how the policy wording captures the principles already set out. Subsequent articles show how the policy deals with capturing the actual indemnification.

As previously pointed out, this all happened 120 years ago. That this happened so long ago, has interesting consequences. Once principles are captured into a document, the principles can be and are usually forgotten. All that now remains are the words contained in the document itself.

Interpreting the document

In this regard Oliver Wendall Holmes, a great American jurist, made a very interesting observation. He pointed out that sometimes society faces a problem and passes laws to deal with that problem. These laws are so effective, that the problem disappears and then we do not know why the laws exist. Then, he warned, creative imaginations will invent their own reasons why the laws were introduced.

Further, as the years pass, new generations may not understand what it is was all about and the document may well acquire a life all of its own.

With documents, the principles may be forgotten and then the issue becomes one of interpretation. However, the interpretation may not be informed by the principles. It is better to interpret the document, in terms of the principles, which in the first place informed the development of the document.

Industry supported policy

In the recent *Ma Afrika business interruption case*, the Supreme Court of Appeal (SCA) expressed the view that the BI policy was very difficult to navigate.

In order to navigate this policy, it is necessary to understand the structure of the well-known MultiMark III (MMIII) industry supported policy.

The MM system has been abandoned, but the details of what happened are best left for a future article. But the SCA is correct, it does indeed need some experience to navigate and interpret.

The MMIII is a single policy document covering a wide range of individual polices, called sections. The insured selects individual sections or policies to get the total desired cover. Accordingly, the business interruption policy is only part of the policy, in the business interruption section. In any policy, what is arguably the most important clause, is the operative clause, or what is known as "the promise".

Strange as this may sound, the operative clause of the business interruption policy is not in the business interruption section at all. It is to be found many pages earlier, at the beginning of the MM III policy which reads:
"… in consideration of… payment of the premium… the company [i.e. insurer]… agrees to indemnify the insured… in respect of the defined events occurring during the period of insurance…"

In the case of business interruption, the defined event is the business interruption, and it is to that section, we must go.

Indemnification of consequential losses

The business interruption indemnification is, in addition, to the property damage policy indemnification. The business interruption policy is not a free-standing policy. If it were, it could end up insuring pure financial losses.

The business interruption policy, therefore, needs to be associated with a property damage policy.

This is all conceptually complex, so how is this complexity captured in the wording of the policy? If the defined event of the business interruption section is read (as it must be), it will be seen to read:
"Loss following interruption of, or interference with the business, in consequence of damage occurring during the period of insurance at the premises of which payment has been made or liability admitted under… the fire section of this policy."

Note, the loss which is insured is the *"loss following interruption… in consequence of damage… at the premises"*. The business interruption is not a perils policy. It does not indemnity for the loss following a fire, or loss following COVID-19. The loss is in consequence of physical damage... at the premises of which liability is admitted under a property damage policy.

So, there it is – the cover for consequential losses arising from the unavailability of the insured property, which is used to produce the revenue, which results in the profit, because of physical damage covered by a property damage policy. It is complex but there it is.

Relying merely on labels

To understand what it covers and does not, take the following common American example. The insured owns a hotel in a hurricane area, and because of a hurricane, the entire area is shut down. The hotel is not damaged, but there is no income. The owner loses income because no customers come, because of the hurricane. Assume, also, that the hotel is insured in terms of an all-risks property damage policy, which includes storm damage. The question, therefore, is whether the insured is entitled to indemnification for the business interruption losses suffered by the insured.



The approach to the answer is, firstly was the property damaged, and second, was an insurer obliged to indemnify the insured for that damage. The answers are, no and no, since the property was not damaged and no indemnification was admitted. The business interruption insurer is not liable to pay anything.

The truth of the matter

In the first article, we cautioned against relying merely on labels. The insured may get upset if relying exclusively on labels. The insured may well say, "This is not fair. I have business interruption insurance and I am also insured against hurricanes, but my insurer refuses to pay the business interruption loss". The truth of the matter is that the insured is insured against property damage which, with the associated consequential loss policy, now includes consequential losses. Since the property is not damaged, there is no consequential loss to be indemnified against. The loss of profits which the insured suffered, in this case, is a pure financial loss which is not indemnified against.

In America, about 2 000 business interruption cases have been instituted against insurers, against the basic policy described above. These cases have hinged on the requirement that physical damage to the property occurs before the policy will respond to the claim.

Increasingly, these cases are being dismissed. The central argument put forward by insureds is, essentially, that not being able to use property has the same outcome as if the property had been physically damaged, therefore they should be paid. The courts have pointed out the wording requires physical damage. Some insureds have tried to argue the presence of the virus at the premises constitutes physical damage, but the courts have dismissed that, pointing out that it is not physical damage in the normal sense of the words.

We need to look at other terms

It should also be noted that thus far, in this article, all we have discussed is how the policy is constructed to pick up consequential losses not covered by property damage policies.

We need to continue to see how the measure of indemnity is determined, as set out in our previous article, and to translate this into policy wording. To do that, we need to continue to look at other terms in the policy. We also need to point out that the MM system was a remarkable achievement of the South African insurance market. It was a single document which attempted to provide cover for a wide range of circumstances.

In a subsequent article, we will continue to discuss the notion of contracts in the neo-classical economic competitive market and question whether insurance is a contract in the usually accepted notion of a contract.


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LOSS OF GROSS PROFIT, CAPTURED BY POLICY WORDINGS



Early attempts to develop this cover were unsuccessful. Cover became possible when the principles applicable to providing consequential loss cover were worked out. We are now considering how these principles were captured by the policy wording.

The rate of the loss

Two heads of losses are insured: (i) due to loss of turnover, and (ii) due to the increase in cost of working (ICW). These are usually referred to as the Insured Gross Profit (IGP). Although it is usual to speak about the IGP, that is not in fact the indemnity figure. The IGP is used to determine the rate of the loss, which when applied, leads to the indemnity figure under heading (i).

To recap the principles:

Turnover (T) = Variable Expenses (V) + Standing Charges (S) + Profit before Tax (Net Profit) (PbT);
Giving the IGP (i) as S + PbT;
And then 100% = V/T + (S + PbT)/T;
Thus, the rate of insured gross profit (i) = (S + PbT)/T;
But T – V = S + PbT;
But T – V; = S + PbT; leading to the difference or additions methods.

It should be noted that T, V, S are actual figures taken from the insured's financials, whereas the Profit before Tax (PbT) is a derived figure.

The terms indemnity period, turnover, revenue, gross profit, net profit, insured standing charges, standard turnover, annual turnover etc. are all defined in the policy. These are thus defined terms.

Loss of gross profit (i)

When a loss or damage to income producing property occurs, this can result in a reduction in the turnover. The reduced turnover means the actual turnover will be less than it would have been if the damage did not occur. A shortage in turnover is experienced.

The actual reduced turnover eventually can be determined from the insured's financial statements. So, one has to start with an estimate of what the turnover would have been, if the damage had not occurred, this estimate is the standard turnover. From the standard turnover, the reduced turnover can be subtracted, to give an estimate of what is usually called the shortage of turnover. The standard turnover is an estimate, a calculated value, not measured from the accounting records.

The shortage of turnover = standard turnover (estimate) – actual reduced turnover.

The indemnity figure is not the shortage of turnover, but the figure arrived at when the rate of the insured gross profit is applied to the shortage of turnover. The amount to be paid as indemnity under heading (i) is:

The shortage of turnover * rate of insured gross profit.

The above principles are captured as follows in the typical wording:

" … insurance is limited to the loss of gross profit due to (a) reduction in turnover and (b) increase in cost of working. The amount payable as indemnity thereunder shall be:

(i) In respect of the reduction of turnover: the sum produced by applying the rate of gross profit to the amount by which the turnover during the indemnity period … falls short of the standard turnover;

(ii) In respect of the increased cost of working: the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction of turnover which, for that expenditure, would have taken place during the indemnity period in consequence of the physical damage, as insured by this policy, but not exceeding the sum produced by applying the rate of gross profit to the amount of the reduction thereby avoided; and

(iii) Less any sum saved during the indemnity period in respect of such of the charges and expenses as may cease or be reduced in consequence of the physical damage insured under this policy."

In this series, we have considered the consequential loss policy. We indicated that consequential losses, although insurable, are not covered by property damage policies.



Shortage of turnover

In this method of determining the indemnity, turnover is used as the basis of the calculation. Turnover during the period of indemnity is used because the damage to the property results in a shortage of what the turnover would have been, had the damage not occurred. So, an estimate has to be made of what the turnover would have been, had the loss not occurred, which is the standard turnover.

The shortage, or reduction represents a loss and thus is the approach the insurance industry is comfortable with. There is a loss for which indemnification is possible. This accords with insurance practice.

The shortage is further adjusted for special circumstances and trends in the business. For the trends to be applied, reliance must be placed on the financial accounts for periods preceding the damage or loss. It should be clear that because the indemnity figure involves several estimates, this policy is subject to a great deal of contention in practice.

The second heading is the increase in the cost of working brought about by the damage to property. It is defined as the expenditure, incurred to mitigate or avoid the reduction in turnover.

Thought needs to be given

Some have expressed the view that the Business Interruption (BI) policy is difficult to understand. Generally, this view is correct. In this series we have taken a slightly different approach to resolving this issue, not starting with the interpretation first, but first understanding the principles and, from these, progressing to the wording. In our view, this is an easier route, than merely looking at and interpreting the wording.

In the recent *Ma Afrika case,* the Supreme Court of Appeal (SCA) dealing with the BI policy noted [Para 33]: "It must be stated at the outset, as we will demonstrate in the paragraphs that follow, that this is not an easy policy to navigate. Counsel for Santam conceded as much."

The operative word is, navigate. The court did not use the word "interpret" but "navigate", and the court is correct. The problem is not only interpreting the wording, but also the construction of the policy document itself.

The industry has designed a documentary system which is very useful and workable but is not that suited to litigation. Also, as time progressed the document was amended, but insufficient thought was given to dealing with the structure of documentation, including the amendments in the form of extensions.

As matters now stand, it is necessary to read parts of the document, in conjunction with numerous other parts and schedules. It is also necessary to read different parts of the document, in relation to other parts, and many parts of the document do not apply to every insured. Clearly, this is going to cause problems where litigation is concerned.

As we have pointed out the consequential loss policy covers consequential losses arising out of damage to the property, which is insured in terms of a property damage policy. It is not a mere interruption policy. But then there are numerous extensions. Some of these extensions do not require loss or damage to the insured's property but still may require loss or damage of some other property, as in the case of the supplier's extension. Some do not appear to require any damage to property at all as in the case of the notifiable disease extension.

Clearly, thought needs to be given, not only to the legal and interpretative issues, but also to the structure of the document and other management issues. This is not the first time these issues have played a part in Business Interruption policies in South Africa.


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Consequential loss policy – COURT CASES



In this series, we have been discussing the consequential loss policy in context. We now turn to discuss some court cases.

The market and others, such as lawyers and judges, may not have the same view of the Business Interruption (BI) policy, because the policy is approached differently by different parties.

The insurance broker is probably best placed to articulate the market view, because the broker presents the insured with an overview of all policies. The purpose of the policy was previously outlined in this series. The insured is exposed to property damage losses, but property damage policies do not cover consequential losses, nor liability claims. Thus, the insured may need three types of policies: property damage, consequential and legal liability policies. If asked what the BI policy covers, the broker could reply that if the insured property is damaged, the consequential loss policy covers the insured's financial losses which arise while the property is not available because of the physical damage.

The broker, as a rule, should not express a view on possible specific losses which may or may not be covered. Historically, the central duty of the broker, as the agent of the insured, is to convey information to and from the insurer. It should be clear, the broker expresses a view before any loss has occurred, and thus without the context of an actual loss.

Lawyers and judges, on the other hand, become involved after an actual loss has occurred. Accordingly, they concentrate on insurance law and interpreting the policy. With this background, some cases are discussed.

City Taylors versus Evans

One of the earlier UK cases, was *City Taylors versus Montague Evans, 1921 CA.* The insurer, in this case, was a Lloyd's syndicate represented by Evans. The insured premises was a clothing factory. It is important to note the year was 1921.

In a previous article, in this series, it was pointed out the BI policy (in its modern form) was first introduced in 1899, and finally accepted by the market in 1939. So, this case is in the in-between period and the policy involved was not the same as the modern post 1939 policy. The cover was on a *per diem* basis.

A fixed sum of money became payable for every day the factory was out of commission. The policy contained the usual term, that in the event of a loss, the insured must take all reasonable steps to mitigate against the loss. A fire broke out, severely damaging the insured factory. The insured immediately moved to a nearby building and recommenced production. It took a year to restore the factory destroyed by the fire.

To the insurers surprise, the insured claimed the *per diem* for the entire year, despite the fact the production recommenced quite quickly after the fire. Since the insured had a duty to mitigate against the loss, and indeed did so, the insurer expected a claim for the period during which production had ceased. This outcome is common sense, and in line with the principle of indemnity.

The court, on the other hand, ruled the insured was entitled to be paid for the full period. One may ask, why did the court take this view? The answer is instructive. The court interpreted the policy to be a valued policy and was not going to allow the parties, post contract, to argue on vague grounds how to determine the quantum of the claim. Obviously, this outcome was not what the market anticipated. The market view and the judicial view differed. After the case, a memo was inserted into the policy, which continues to this day:

"If, during the indemnity period, goods shall be sold or services shall be rendered elsewhere than at the premises for the benefit of the business, either by the insured or by others on their behalf, the money paid or payable in respect of such sales or services shall be brought into account in arriving at the turnover, revenue or gross rentals during the indemnity period."

The market response was to clarify its position. In any event, the standard policy, adopted after 1939, is vastly different to the per diem policy applicable in the City Taylor case. However, for our purpose, it is important to note the market and judicial view may not coincide. The market remedy is then to amend the policy wording.

Orient Express Hotels

We now discuss a more recent case; the *Orient Express Hotels (OEH) 2010* case. The case arose out of Hurricane Katrina, which was followed by Hurricane Rita in New Orleans, in the autumn of 2005.

Wind and water caused significant physical damage to the hotel. The hotel was closed from September to the end of October 2005. In the month of September, when New Orleans itself was shut down, OEH suffered millions of Rands in BI losses.

It was insured in terms of an all-risks policy with a standard business interruption section. This policy contained a number of widely worded extensions, including the Prevention of Access and Loss of Attraction extensions. The insurer admitted liability for material damage losses, in terms of the all-risks policy. It also admitted liability in terms of the Prevention of Access and Loss of Attraction extensions, but repudiated the BI claim.

The BI dispute was taken to arbitration, which found in favour of the insurer, and the decision of the Tribunal was taken on appeal to the High Court, alleging an error in law; viz the interpretation of the policy.

The insured argued it was insured against physical damage on an all-risks basis and suffered physical damage and a BI loss. It argued that the BI claim fell within the purview of the policy. The insurer repudiated the claim for BI loss on the grounds that, even if there was no physical damage, the BI would still have occurred because New Orleans had been shut down. The BI loss did not arise from the physical damage.

The basis of the rejection was that even if the hotel had not been damaged, the impact of the hurricanes to the surrounding area would, in any event, have caused the same BI loss of the insured. The insured peril for the BI policy was submitted by the insurer, to be the damage to the property itself. The hurricane was the event which caused the physical damage, but the physical damage did not cause the BI loss. This argument was accepted by the arbitration panel.

Amount payable as indemnity

The Court agreed and dismissed the appeal on the basis that no error in law had been established.

The decision of the arbitration panel and the High Court accorded with the historical market understanding of the policy.

The consequential loss policy covers the insured against the revenue loss, which arises out of the damage to the property covered by a property damage policy. As noted above, the courts pointed out from the beginning that the BI policy is a valued policy. The policy must set out the basis of determining the indemnity figure.

The point of departure is the actual revenue earned. In this case, the revenue earned in the month of September was zero. The next step is to determine the standard revenue, the revenue which would have been earned if the property had not been damaged. The starting point to this step is the revenue in the previous 12 months.

So, assume the revenue in September 2004 was $3 million. This figure must then be adjusted to take the trend into consideration. In September 2005, the revenue would have been zero, since New Orleans was in lockdown due to the hurricane. So, the revenue of September 2004 needs to be adjusted down to zero. The amount payable as indemnity is $3 million, minus $3 million, which equals zero. The process set out in the policy is the process to be followed.

Thus, in terms of the fundamental principles of the BI policy, the decision of the arbitration panel was correct, and the High Court correctly did not to overturn the decision.

In the next part of the series, we discuss the view of the courts in the COVID-19 litigation when they reconsidered the Orient Express Hotel case.


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Overturning of the Orient Express Hotel... UNNECESSARY

In the previous article, we discussed the Orient Express Hotel (2010) case, which was dealt with by an arbitration Tribunal and taken on appeal to the High Court (2010) which upheld the decision of the Tribunal. A further appeal was noted to the Court of Appeal, but the case was settled and, thus, that appeal did not continue. The 2010 decision was, however, overturned as part of the COVID-19 litigation: by both the High Court (2020) and the Supreme Court (2021). We have reservations about this overturning for reasons set out in this article.

To recap, an Orient Express Hotel was situated in New Orleans. In August 2005, New Orleans was struck by Hurricane Katrina, followed by Hurricane Rita. The hotel was damaged and New Orleans was shut down in the month of September 2005. Therefore, there was no business generated in New Orleans for the month of September.

The basis of the case

The hotel submitted several claims which were paid. It also submitted a Business Interruption (BI) claim for the month of September. It is this claim which was the subject matter of the arbitration Tribunal and the High Court (2010).

The insurer repudiated the claim. The basis of the rejection was the fact that the insured's revenue loss would have been zero with or without the damage to the hotel, because of the hurricanes. It is this rejection, which was upheld in 2010, by the Tribunal and then the High Court.

The fundamental principles

The approach we have adopted, in this series, is to first set out the fundamental principles and apply these to the facts.

Since 1899, when the principles were set out, the basis of insurance was the loss of revenue, because of the physical damage to the insured property. So, the point of departure is, what would the revenue have been if the hotel had not been damaged? Clearly, the revenue would have been zero, not because of the damage to the hotel but because of the hurricanes.

So, in principle, the original 2010 decision is correct. That is the same outcome which would have been arrived at, at any time over the past 120 years. So, how did the recent courts come to a different conclusion?

Let us first discuss the High Court (2010) decision, and then the Supreme Court (2021) decision. The case was leapfrogged directly to the Supreme Court and, thus, the Court of Appeal was not involved.



The High Court (2020) case

In must be borne in mind that the COVID-19 litigation involved the contagious disease extension, and not the main policy. On the other hand, the Orient Express case involved the main policy and not an extension. The contagious disease extension did not require damage to the insured property, whereas the standard main BI policy did.

The court saw a single all-risks policy insuring against material damage and consequential business interruption. As repeatedly pointed out, there are two policies, not one. The operative clause of the BI policy is damage to the property. The operative clause of the property damage policy is all risks.

If the policy is read, then it becomes clear that the proximate cause of the consequential loss policy is damage to the insured property itself, and nothing else. If the property is damaged, it cannot be used to produce the revenue.

The insurer is liable to indemnify against revenue losses caused by the damage to the insured property and is not liable for losses caused from any other cause. It is not liable, for example, to indemnify interruption losses caused by the hurricane. In the High Court (2020), the court concluded that, "the insured peril is..., business interruption arising from damage as a consequence of the hurricanes." The court argued the damage is not confined to damage to the insured property, but damage to the area in general. That is not what the operative clause says. The court came to this conclusion because it "recognised that hurricanes were an integral part of the insured peril." It may well be an integral part of the property damage peril, but not the consequential loss policy.

This point was clearly made in 2010, by the Tribunal and High Court. The peril of the Business Interruption policy is damage to the property, which causes the reduction in the revenue. This is clear from the operative clause of the interruption policy quoted in the judgement.



"In consideration of the insured... paying the premium... the insurers... agree... to indemnify the insured against loss due to interruption or interference with the business directly arising from damage."

The court did, however, go on, to state the overturning of the Orient Express Hotel (2010) case was not necessary for the purposes of the COVID-19 litigation, since the litigation could be distinguished from the original 2010 decision. The 2020 High Court case, as a guide to future cases, should not be construed as overturning the Orient Express Hotel case.

The Supreme Court (2021) case

The Supreme Court (2021) concluded that the Orient Express Hotel case should be overturned. Two of the judges of the Supreme Court were involved in the earlier case (2010), one as part of the tribunal and the other as the High Court judge. They essentially overruled their own previous decisions.

Let us follow their logic. They started by pointing out that the High Court (2010) decision was arrived at via a very restrictive route. It was as an appeal from a Tribunal and the Court's scope was limited to considering the questions of law.

We agree with that. This is the same argument we make concerning the overturning. The COVID-19 cases arrived via an unusual route and, if litigated in the normal fashion, the outcome could have been different. The overturning of the Orient Express Hotel was through the lens of the COVID-19 litigation. If it was seen from a different perspective, it may have resulted in a different outcome. The second point the court made was that all court cases are usually the product of the way the cases are framed and argued by the parties before the court. Framed differently, a different outcome may evolve.

The judges took into consideration the damage done to the surrounding areas, as an integral part of the loss. The court used an example by Hickmott (1990). Assume there is a hotel on an island, which has a bridge linking the island to the mainland. A storm damages both the hotel and bridge. Does the hotel have a valid BI claim? An argument would be that it does not, because even if the hotel was not damaged, its revenue would still be zero since the bridge was down. Hickmott expressed the opinion that in terms of market practice the BI loss would be assessed as if the bridge had not been damaged.

The court now argued this is because the same peril damaged both the hotel and the bridge. In light of this type of example, the court concluded that if a hotel is situated in an area which is also damaged, this cannot be taken into consideration to reduce the quantum of the loss. Hickmott is probably correct, but not because of it is market practice, but because of the prevention of access extension to the policy. The extension applies if property within a 10 km radius is destroyed or damaged, which hinders or prevents access to the insured property, causing the interruption loss.

Future claims

The Covid BI litigation dealt with the contagious disease extension. Reinsurers have already excluded any future claims to avoid a re-run of the Covid litigation.

The overturning of the Orient Express Hotel decision, which involved the main policy, should be seen in this light. We reinforce the High Court (2010) view that the overturning was unnecessary for the purposes of the Covid litigation.



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Extensions to the BUSINESS INTERRUPTION (BI) POLICY

In previous articles, we pointed out that Covid Business Interruption (BI) litigation dealt with a once in a lifetime event of a pandemic and its consequence of a virtual worldwide lockdown.

The United Kingdom and South African litigation involved a contagious disease extension. This extension does not form part of the United States policies, and thus, the United States litigation is different. For historical reasons the US has a highly regulated insurance market.

In this article, we discuss the purpose of various extensions. We also explain that if these extensions were understood, it was unnecessary for the UK High Court and Supreme Court to "overturn" the earlier decision of the Orient-Express case. We also suggest that non-material damage losses should be separately insured, and not form part of the BI policy, as is currently the practice in South Africa.

Extensions to the main policy

The main BI policy provides cover for consequential losses, caused by the insured property being damaged. An insured can also incur consequential losses, if third party property is damaged. Some of these losses can be covered by extensions to the main policy. Damage to property is still a requirement for the extension, but not damage to the insured property.

That there is an obvious need for these extensions can be easily illustrated. Assume a business is dependent on components manufactured by a supplier. In the event of a fire at the supplier's premises, the insured, without the components, would suffer a loss of revenue. The business interruption policy could have an extension, which would cover consequential losses in the event of a fire at the supplier's premises.

The BI policy contains a number of standard extensions, covering losses incurred by the insured from damage to property at:

- Specified and unspecified suppliers;
- Property and vehicles of the insured being stored or in transit;
- Contract sites;
- Resulting in prevention of access;
- Additional premises;
- Customers;
- Public utilities; and
- Public communications.

Non-material damage cover

Insurance evolved to provide indemnity for accidental loss or damage, which by its nature, is tangible. Accidental means the event of the loss can be located at a specific point in time and place. Tangible means clearly visible, as in the case of damage to physical property or death or injury to people. All of this is practical and observable, making insurance workable. These evolved to risks being insurable.

Initially, insurance cover did not include consequential losses, which only start to accrue after the event and are non-tangible. Clearly, cover for this kind of loss required some effort to design a workable policy. And thus, the BI policy evolved. This policy, as should now be clear, was still clearly and specifically tied to actual damage to property. BI cover is, thus, part of property insurance. Non-property damage losses fall outside of the historical mainstream scope of insurance.

Nevertheless, there has been a rise in this form of cover. It is recommended that this form of loss should be covered by a separate policy. These losses should not be covered as extensions to property damage policies. They simply do not fit within the policy. As should now be clear placing this non-fitting cover within the BI policy can cause problems.

Notifiable disease cover

The cover arising from a notifiable disease involves non-material damage cover. In many cases it was provided and treated as an extension to the BI policy. It was widely included as cover within the hospitality industry, covering hotels, Bed and Breakfasts (B&Bs), restaurants etc. It is a common extension in policies for hotels and restaurants.

Typically, the clause reads: "Loss... resulting in interruption... with business due to:

(a) Murder or suicide at the premises;
(b) A notifiable disease occurring at the premises;
(c) Closure of the premises due to defective sanitation;
(d) A notifiable disease occurring within a radius of 40 km of the premises;
(e) ...
(f) ...
(g) Shark attack.

It should be clear an attempt was made to still link the cover to the premises. What triggered the cover? The World Health Organisation (WHO) announced that a breakout of COVID-19 had occurred, and the outbreak displayed pandemic characteristics. Almost immediately, a state of disaster was called, and the lockdown instituted. Insureds took the view they were covered in terms of the above extension, but insurers took the view that the interruption was caused by the action of the government in imposing the lockdown.

The lockdown was not linked to any premises. The question became one of causation. To resolve this aspect of the dispute, the courts resorted to the concept of proximate cause, which is nowadays interpreted as the effective cause. The argument was that the effective cause of the lockdown was the virus, and thus, the interruption loss was caused by the virus - a notifiable disease.

This was the logic which came from an earlier case. A ship was struck by a torpedo. It limped to the harbour, but on arrival, the harbour master would not let it enter into the harbour. While outside the harbour, there was a storm or heavy seas and the ship sunk. Did it sink because of the storm or the torpedo? Was it normal or war damage? Was it the normal perils of the sea? The court ruled the effective cause was the torpedo leading to war damage.

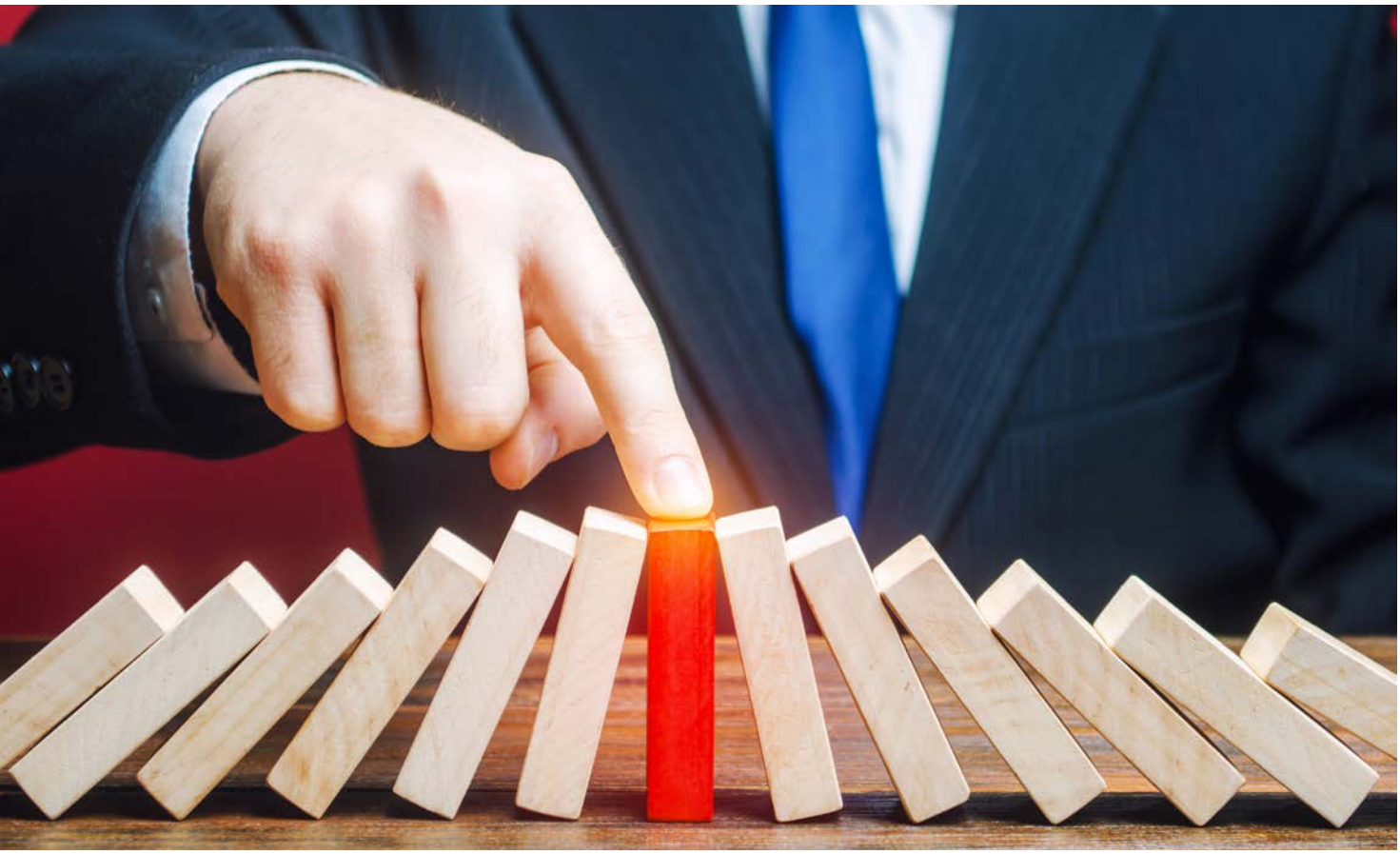
It was, thus, accepted based on proximate cause that the BI claim was covered, but the question then is how is the quantum calculated? The basis of the BI policy is the loss of revenue experienced, while the premises is being repaired. In this case, the premises was not damaged, and thus, was not going to be repaired. So, the provisions of the policy simply did not fit and there is no point in trying to make it fit. How then, can this dilemma be resolved?

The court did not, but could have, followed the approach courts had adopted at the beginning of the 1900s. It stated unequivocally that the BI policy is a valued policy. As such, the policy itself must specify how the quantum will be calculated, and if it does not, the court would not attempt to write the policy while dealing with a claim. The court took a straightforward approach; if it is covered, then it is covered. The court would uphold the policy and the insurer would be liable. Going forward, the insurer would then have to formulate the basis of its liability more clearly, with specific wording. There was, thus, no need for the court to deal with the trends clause – it clearly did not fit, and thus, did not apply. There was no need to overturn the Orient Express case, to make it fit.

What has been emphasised

This brings us to end of the series, on BI insurance, except for a post-script. What has been emphasised in this series, is that business interruption was designed to provide cover in instances where property is damaged and covered by a property damage policy. It is not a free-standing BI policy. COVID-19 did not cause physical damage to insured property, and thus, conceptually does not fall within the ambit of BI cover. Covid was a non-material damage event.

Non-material damage cover is making an ever-increasing appearance. In many instances, this has been done by inserting an extension into the property damage policy. This can cause considerable problems for the industry, including reinsurers. It is suggested that non-material damage cover, when provided, should be provided in terms of a separate non-material damage policy. ●





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BI POLICY: CASES PRIOR TO COVID-19

As indicated, the BI policy was introduced 120 years ago, but until now, there were very few cases. So, the list is not long. The following are the pre-COVID-19 BI cases:

- *Govender versus Mutual and Federal Insurance Company 2005 CLR 257 (D);*
- *Mutual and Federal Insurance Co Ltd versus Chemalum (Pty) Ltd 2007 (2) SA 479 (SCA); and*
- *PFC Food CC versus Three Peaks Management (Pty) Ltd 2012 ZAKZDHC 57.*

Not only is this a short list, but two of them threw a little light on the BI policy.

Govender case

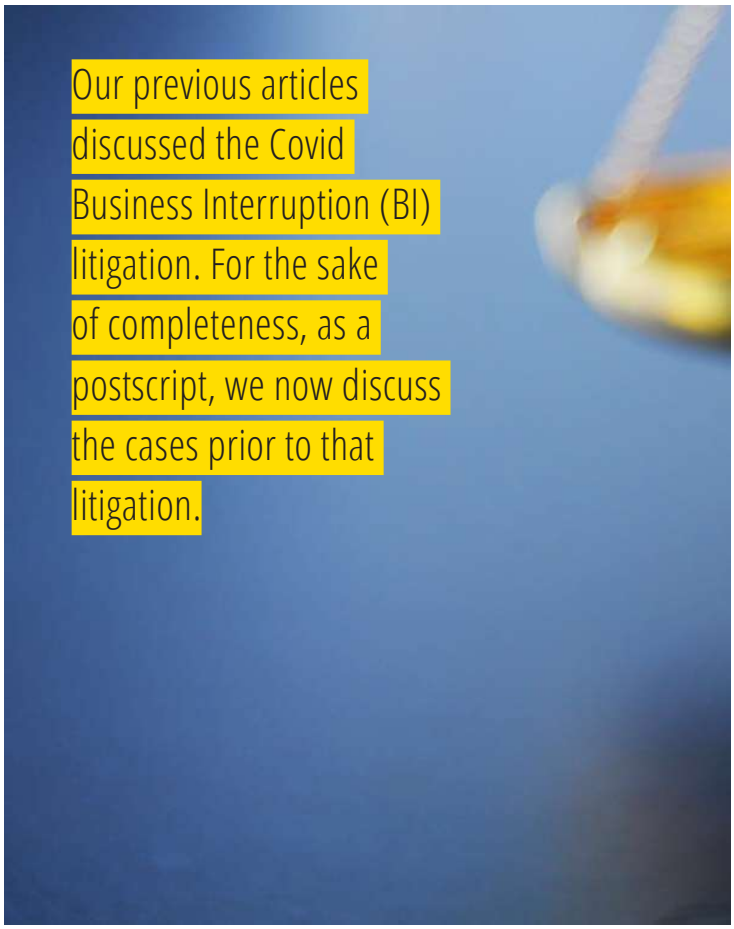
The Govender case was discussed in Juta's Insurance Law Bulletin. In the Govender case, the policy involved was the Multimark Policy. This policy document, as is well-known, consists of a number of sections. The cover provided depends on which sections are selected. The Multimark system is complex, and the sections do not always dovetail seamlessly. Each section has its own schedule, and these too, do not always dovetail seamlessly. To make matters worse, it has happened that in interpretating a particular section, reference has been made to sections not selected by the insured to reach a conclusion. Essentially using a non-contract document to arrive at a contractual conclusion.

In the Govender case, the issue facing the court arose because the sections and schedules did not fit. As we have explained, the BI policy (section in MultiMark) covers consequential losses arising from damage to property, covered by a property damage policy. In the Multimark system, property damage cover is provided in terms of another section, such as the fire section. So, the cover requires reading two sections together, and two schedules – enough to confuse the uninitiated!

The fire section, in the Govender case, provided property damage cover for the insured property if damaged by fire. The property was listed in the schedule, to the fire section. Two properties were listed.

On the other hand, the BI section has its own schedule. However, the BI section itself did not refer to any schedule. Nevertheless, the BI section schedule listed only one of the two properties. The fire occurred at the property, which was not referred to in the BI section, but was referred to in the fire section. The court had to decide whether the damaged property was in fact covered by the BI section, despite not being listed. So, the situation was as follows, with the BI operative clause reading *"Loss … at a premises in respect of which payment had been made or liability admitted under the fire section."*

Well, the fire section responded to the property damage claim and, thus, liability was admitted, and the BI section did not limit the cover to properties covered by the schedule to the BI section. So, the court had to decide if the BI policy responded to the claim because the fire section responded. The court decided in favour of the insured.



As matters then stood, if cover is provided under the BI section, it covers all the premises listed in the fire section. Clearly, this probably is not what the insurer intended. This interpretation increased the exposure of insurers, where the insurer did not intend to provide this cover under the BI section. A remedy is for the operative clause, in the BI section, to refer to the BI schedule.

Further, to avoid confusion of what is covered under the Multimark Policy, sections not selected should be removed.

It should be clear that although this is a BI claim, it did not involve a BI issue. The issue was one of interpretation and construction of the MultiMark documents. This is a practical administration matter. Once again, the industry fell victim to the complexity of the MultiMark System in the Ma-Africa case!

Mutual and Federal, Chemalum case

The Chemalum case dealt with the question of average, as applied to the BI policy. As previously indicated, the BI policy is a valued policy, and thus, the basis of indemnification is to be found in the wording of the policy itself. The wording is complex, and the policy is equally complex to deal with and complex to apply in practice. We have indicated how the defined indemnity is to be determined. When a loss occurs, the insured suffers a decrease in turnover (as



often said in practice – a shortage in turnover) and possibly also an increase in the cost of working.

The actual turnover can be determined from the accounting records. The turnover, which would have been earned, cannot be determined from the accounting records, so an estimate needs to be made. The basis of this estimated turnover is the standard turnover. Knowing the actual turnover and estimating the turnover which would have been earned - the standard turnover - the shortage can be determined.

What is also needed, however, is to know the sum insured, so that this can be compared to the actual value of the loss. These two should be the same, and if so, the sum insured is correct. If it is lower than that, then the insured is under-insured, and the insurer can apply the average. The sum insured is determined from the annual turnover, as defined, and specified in the policy.

In the Chemalum case, when the annual turnover was determined and compared with the sum insured, it was clear that the insured was underinsured, and the insurer applied an average. The insured disputed this. The High Court decided that there was no need to make an adjustment according to the average clause. It is easy to arrive at this decision, because of the complexities of the policy. On appeal, the Supreme Court of Appeal (SCA) found that the adjustment had to be made, as per the requirements of the average clause. The decision reached was that the insured was underinsured by 58%. The liability of the insurer was reduced, because of the correct application of the average clause. It is imperative for insureds to correct BI exposure, and to pay the correct premium. It is not, however, a simple matter to determine the sum insured, as illustrated by the next case.

This case did involve the BI principles and, thus, we can conclude that in 120 years, there has only been one real BI case!

The PFC Food, Three Peaks Management case

The third BI case, that of PFC Food CC, was a PI claim against a broker. It, thus, did not involve an interpretation of the BI policy, per se. It does illustrate the practical difficulties in determining the correct sum insured.

When the insured event occurred, and a claim was submitted, it was then discovered that the insured was underinsured, and the insurer applied the average. The insured successfully sued the broker, alleging that the broker had breached its obligations with respect to the problem of underinsurance.

The case focused on the duties of the broker and there was no in-depth consideration of the BI policy. It was known to both parties that the broker did not attempt to interpret the insured's financial statements to determine the correct sum insured. The broker did arrange a meeting between the insured and insurer. As indicated, the insured's claim against the broker was successful. A BI calculator has been developed.

Valuable light on the BI policy

At the beginning of this series of articles, the point was made that the BI policy is considered as one of the most complex of policies and, as such, is not generally fully understood.

This is compounded by the fact that the policy has received very little judicial interpretation, which usually assists to understand the policy. The COVID-19 litigation has assisted in throwing valuable light on this policy.



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