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Newsletter

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What's inside?

UK Supreme Court rules on arbitrator impartiality and duty to make disclosure

KK Cheung

The recent judgment from the Supreme Court of the United Kingdom on Halliburton Company v Chubb Bermuda Insurance Ltd [2020] UKSC 48, raised important questions about the requirement that there can not only be no actual bias, but also no apparent bias on the part of arbitrators in favour of or against any party in arbitration and also about the obligation of arbitrators in international arbitrations to make disclosure of multiple appointments concerning the same or overlapping subject matter with one common party. The court allowed a number of arbitral institutions to intervene and make submissions in the proceedings, including, for example, the ICC and CIArb, which indicates the significance of this judgment in the arbitration field, in particular, arbitrations seated in England.

Background

The appeal concerned an arbitration under a Bermuda Form liability policy arising out of damage caused by an explosion on the Deepwater Horizon drilling rig in the Gulf of Mexico in 2010. The disaster gave rise to several arbitrations between insured parties and insurers. The Bermuda Form policy was governed by New York law and provided for London-seated ad hoc arbitration.

In January 2015, Halliburton commenced arbitration proceedings against Chubb (Reference 1). They agreed the appointment of two arbitrators, but being unable to agree on the third arbitrator, the High Court appointed Kenneth Rokison QC in June 2015, who had been proposed by Chubb, but objected to by Halliburton on the grounds that he was an English lawyer, whereas the relevant policy was governed by New York law. Prior to his appointment, Mr Rokison had disclosed that he had previously acted as an arbitrator in a number of arbitrations involving Chubb, including some appointments on behalf of Chubb, and that he was currently appointed as arbitrator in two pending references in which Chubb was involved.

In December 2015 Mr Rokison accepted the appointment as an arbitrator by Chubb in relation to an excess liability claim by Transocean, arising out of the same incident (Reference 2). The appointment was made on behalf of Chubb by Clyde & Co, who were also Chubb's solicitors in Reference 1. Within Chubb, the same manager was responsible for monitoring the claims made by both Halliburton and Transocean and took the decision to refuse the claims in each case. Before accepting appointment by Chubb in Reference 2, Mr Rokison disclosed to Transocean his appointment in Reference 1

and in the other Chubb arbitrations which he had disclosed to Halliburton. Transocean did not object. However, Mr Rokison did not disclose to Halliburton his proposed appointment by Chubb in Reference 2.

In August 2016 Mr Rokison accepted appointment (Reference 3) in another arbitration, arising out of the same incident, as a substitute arbitrator on the joint nomination of the parties in a claim made by Transocean against a different insurer on the same layer of insurance as the claim in Reference 2. Nobody disclosed this proposed appointment to Halliburton.

Halliburton became aware of the December 2015 and August 2016 appointments of Mr Rokison in November 2016 and asked him to resign. Mr Rokison refused because, in his view, the issues under consideration were neither the same nor similar and he had been independent and impartial throughout and that would continue to be the case. Halliburton made an application to the English High Court for his removal. The application was unsuccessful, as was Halliburton's appeal to the Court of Appeal.

Halliburton's Case

Halliburton did not suggest that Mr Rokison was guilty of any deliberate wrongdoing or actual bias. Its case was one of apparent unconscious bias, founded on the following:

- Mr Rokison accepted the benefit of a paid appointment on Chubb's nomination when he was sitting on an arbitral tribunal in Reference 1.
- In so doing, he gave Chubb the unfair advantage of being a common party to two related arbitrations with a joint arbitrator, while Halliburton was ignorant of the proceedings in Reference 2 and thus unaware whether and to what extent he would be influenced in Reference 1 by the arguments and evidence in Reference 2.
- Chubb would be able to communicate with him in Reference 2, e.g. by its submissions and the evidence it led, on matters which might be relevant to Reference 1 and would know of his responses to those communications, while Halliburton would not even know that they had occurred.
- Mr Rokison failed to disclose his appointment to Halliburton and thereby prevented it from forming its own view as to whether it might lead to unfairness and from either making submissions to the tribunal in Reference 1 or otherwise proposing or taking practical steps to mitigate the unfairness.
- Mr Rokison did not pay proper regard to Halliburton's interest in the fairness of the procedure. Mr Rokison had regard only to what he and Chubb both wanted, which was his appointment to sit as arbitrator in Reference 2.
- The fair-minded and informed observer would see such conduct as giving rise to justifiable doubts as to the arbitrator's impartiality.

Issues before the Supreme Court and its findings

There were two main issues raised in the appeal, which the Supreme Court answered as follows:

(i) whether and to what extent an arbitrator may accept appointments in multiple references concerning the same or overlapping subject matter with only one common party, without thereby giving rise to an appearance of bias.

Where an arbitrator accepts appointments in multiple references concerning the same or overlapping subject matter with only one common party, this may, depending on the relevant custom and practice, give rise to an appearance of bias.

(ii) whether and to what extent the arbitrator may do so without disclosure

Unless the parties to the arbitration agree otherwise, arbitrators have a legal duty to make disclosure of facts and circumstances which would or might reasonably give rise to the appearance of bias. The fact that an arbitrator has accepted appointments in multiple references concerning the same or overlapping subject matter with only one common party is a matter which may have to be disclosed, depending upon the customs and practice in the relevant field. In cases in which disclosure is called for, the acceptance of those appointments and the failure by the arbitrator to disclose the appointments taken in combination might well give rise to the appearance of bias.

The reasons for coming to the above conclusions are detailed below.

Test for apparent bias

The Supreme Court emphasised the importance of the obligation of impartiality in arbitrations and that impartiality has always been a "cardinal duty" of arbitrators. It confirmed that the English courts in addressing an allegation of apparent bias in an English-seated arbitration will (i) apply an objective test, namely "whether the fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased"; and (ii) have regard to the particular characteristics of international arbitration, which highlight the importance of proper disclosure as a means of maintaining the integrity of international arbitration. These characteristics include, for example, the private nature of arbitration, the fact that an arbitrator has a financial interest in being nominated, that arbitrators in international arbitration come from many jurisdictions and legal traditions and may have divergent views on what constitutes ethically acceptable conduct and that in the field of international arbitration there are differing understandings of the role and obligations of the party-appointed arbitrator (some legal systems accept the proposition that a party-appointed arbitrator has a special role in relation to his/her appointing party).

In relation to the time of assessment of the possibility of bias, the Supreme Court confirmed that the test to apply was to ask whether "at the time of the hearing to remove" the circumstances would have led the fair-minded and informed observer to conclude that there was in fact a real possibility of bias.

Legal duty to disclose

The Supreme Court confirmed that the arbitrator's duty of disclosure is a legal duty under English law and not simply good arbitral practice. It is a component of the arbitrator's statutory obligations of fairness and impartiality.

The Supreme Court said that an arbitrator, like a judge, must always be alive to the possibility of apparent bias and of actual but unconscious bias. One way in which an arbitrator can avoid the appearance of bias, the Court said, is by disclosing matters which could arguably be said to give rise to a real possibility of bias. When, on being asked to accept an appointment, an arbitrator knows of a matter which ought to be disclosed to the parties to the reference, prompt disclosure to those parties of that matter provides the safeguard, as the quality of impartiality is shown to have been there from the beginning. But the obligation of impartiality continues throughout the reference and the emergence during the currency of the reference of matters which ought to be disclosed means that an arbitrator's prompt disclosure of those matters can enable him or her to maintain the "badge of impartiality".

The Court said that an arbitrator's failure to make disclosure is a factor for the fair-minded and informed observer to take into account in assessing whether there is a real possibility of bias. Such assessment will have regard to facts and circumstances as at and from the date the duty arose and will be made as at the date of the hearing to remove the arbitrator.

Practice in relation to disclosure

Since the legal duty of disclosure does not override an arbitrator's duty of privacy and confidentiality in English law, the Supreme Court also considered how in practice an arbitrator was to make disclosure and what matters he could disclose. The court sought guidance from the parties and interveners on the practice in relation to disclosure of facts concerning a related arbitration or arbitrations without obtaining the express permission of the parties to the arbitration about which information was being disclosed. That guidance made it clear that there were a variety of arbitral practices in relation to the acceptance of appointments in multiple references concerning the same or overlapping subject matter with only one common party. What is appropriate for arbitration in which the parties have submitted to institutional rules, such as those of ICC and LCIA, differs from the practice in GAFTA and LMAA arbitrations. There are practices in maritime, sports and commodities arbitrations, as the IBA Guidelines recognise, in which engagement in multiple overlapping arbitrations does not need to be disclosed because it is not generally perceived as calling into question an arbitrator's impartiality or giving rise to unfairness. The Court said:

- Where the information which must be disclosed is subject to an arbitrator's duty of privacy and confidentiality, disclosure can be made only if the parties to whom the obligations are owed give their consent. If a person seeking appointment as an arbitrator in a later arbitration does not obtain the consent of the parties to a prior related arbitration to make a necessary disclosure about it, or the parties to the later arbitration do not consent to the arbitrator's disclosure of confidential matters relating to that prospective appointment to the parties to the earlier arbitration, the arbitrator will have to decline the second appointment. Such consent may be express or inferred from the arbitration agreement itself in the context of the custom and practice in the relevant field.

- In arbitrations governed by institutional rules which require disclosure to the institution or parties of matters which may include information about other arbitrations (such as the ICC Arbitration Rules), the incorporation of such rules into an arbitration (arbitration 1) provides a basis for the inference that the parties to that arbitration consent to disclosure of such information about that arbitration to the parties to a prospective arbitration (arbitration 2) under such rules. Similarly, one can readily infer from the submission of the parties in arbitration 2 to such rules that they have consented to such disclosure to the parties to arbitration 1.

- Where parties submit to an ad hoc arbitration, practice as to privacy, confidentiality and disclosure may differ. Such arbitrations may include those in which the parties maintain the confidentiality of the existence of the arbitration itself by prohibiting any disclosure whatsoever. In such case, consent of both parties to the arbitration would be required to enable an arbitrator to disclose its existence to the parties to another arbitration. Whether an arbitrator can make disclosure of an existing or prospective arbitration without first obtaining the express consent of all parties to the arbitration about which disclosure requires to be made will depend on the relevant arbitration agreement and the custom and practice in the relevant field.

- The duty of privacy and confidentiality is not absolute. The parties to an arbitration can determine as a matter of contract the extent to which they wish matters to be treated as confidential.

- The Court of Appeal's formulation of disclosure (that disclosure should be given of facts and circumstances known to the arbitrator which would or might give rise to justifiable doubts as to his impartiality) was correct, subject to one qualification concerning the words "known to the arbitrator". An arbitrator can disclose only what he or she knows and is, as a generality, not required to search for facts or circumstances to disclose. But the possibility of circumstances occurring in which an arbitrator would be under a duty to make reasonable enquiries in order to comply with the duty of disclosure was not ruled out.

Did the arbitrator in this case have to disclose his multiple appointments?

It was accepted that it was not uncommon for arbitrators in Bermuda Form arbitrations to disclose their involvement in prior or current arbitrations involving a common party without disclosing the identity of the other party or details concerning the arbitration, but the parties disagreed as to the practice of disclosure. The Court said that under English law multiple appointments must be disclosed in the context of Bermuda Form arbitrations in the absence of an agreement to the contrary between the parties to whom disclosure would otherwise be made. It had not been shown that there was an established custom or practice in Bermuda Form arbitrations by which parties have accepted that an arbitrator may take on such multiple appointments without disclosure.

The Court said that on appointment as arbitrator in Reference 1, Mr Rokison became subject to the statutory duties to act fairly and impartially in conducting arbitral proceedings, in decisions on matters of procedure and evidence and in the exercise of all powers conferred on him. Those duties were owed to both Halliburton and Chubb. Relevant information and the opportunity for communication with the common arbitrator were available to Chubb in Reference 2 which were not available to Halliburton. Being unaware of the appointment in Reference 2, Halliburton was not able to assess whether and to what extent this involved unfairness and how to respond to that appointment. The appointment in Reference 2 had the potential to give rise to unfairness, which Halliburton had no opportunity to address. The failure to give a party to an arbitration that opportunity, might amount to apparent bias.

However, having regard to the circumstances known to the court at the date of the hearing at first instance, the Court was not persuaded that the fair-minded and informed observer would infer from the oversight that there was a real possibility of unconscious bias on Mr Rokison's part because:

- at the relevant time, there appeared to have been a lack of clarity in English case law as to whether there was a legal duty of disclosure and whether disclosure was needed;

- the time sequence of the three references may explain why Mr Rokison saw the need to disclose Reference 1 to Transocean but did not identify the need to tell Halliburton about Reference 2.

- Mr Rokison had explained that it was likely that References 2 and 3 would be resolved by a preliminary issue and that there would not be any overlap in evidence or legal submissions between them and Reference 1. If that had not been the outcome of the preliminary issues, he had also offered to consider resigning from his appointments in References 2 and 3.

- there was no question of Mr Rokison having received any secret financial benefit;

- there was no basis for inferring unconscious bias in the form of subconscious ill-will in response to Halliburton's challenge to his appointment.

The Supreme Court was therefore satisfied that the Court of First Instance and Court of Appeal were correct to hold that the fair-minded and informed observer, looking at the facts and circumstances which would be known to him or her at the date of the hearing in January 2017, would not conclude that there was a real possibility of bias or, in the words of s.24(1)(a) of the 1996 Arbitration Act, that circumstances existed that gave rise to justifiable doubts about Mr Rokison's impartiality. The appeal therefore failed.

Comment

This important judgment clarifies the nature of an arbitrator's duty to make disclosures of facts and circumstances that may give rise to doubts about the arbitrator's independence and impartiality and also how in practice disclosure is to be made, given an arbitrator's duty of privacy and confidentiality. This confirms that there may be circumstances in which the acceptance of appointments in multiple references concerning the same or overlapping subject matter with only one common party might reasonably cause the objective observer to conclude that there is a real possibility of bias and whether the objective observer would reach that conclusion will depend on the facts of the particular case and especially upon the custom and practice in the relevant field of arbitration.

If an arbitrator is in doubt as to whether certain facts or circumstances have to be disclosed to the parties, he should disclose them to err on the side of caution. Arbitrators may refer to the IBA Guidelines on Conflicts of Interest in International Arbitration which sets out various situations which may or may not warrant disclosure to the parties to the arbitration.

England's Court of Appeal restates principles applicable to "subject to contract" negotiations

Joseph Chung

In Joanne Properties Ltd v Moneything Capital Ltd and Anor [2020] EWCA Civ 1541, England's Court of Appeal had to decide whether the parties had entered into a binding contract of compromise contained in written communications passing between their respective solicitors. The Court below had held that a binding contract had been made, despite the fact that the correspondence in question had been marked "subject to contract". The Court of Appeal reversed that decision, holding that a binding contact had not been reached and that the judge below had applied the wrong test and had he applied the correct test, he could not have reasonably concluded that a binding contract had been made.

Background

Joanne Properties Ltd (Joanne) owned a building and borrowed money from the Respondents (Moneything) secured by a legal charge over the property. Joanne fell into arrears under the charge and Moneything appointed receivers. Joanne challenged that appointment on the ground that both the loan agreement and charge had been procured by undue influence. Joanne issued a claim against Moneything seeking to set aside both the loan agreement and charge and also sought an injunction against the receivers preventing them from taking any further steps to realise the security.

The parties compromised the application for an injunction and agreed that the property should be sold and an order made for distribution of the sale proceeds. After payment of the costs of sale and capital advanced under the loan agreement, £140,000 was to be ring-fenced, representing sums that may be determined to be payable to either party, subject to the terms on which the claim was resolved; and any balance was to be ring-fenced for the resolution of a dispute relating to another charge over the property in favour of a third party. The agreement was embodied in a formal written agreement signed by each party.

Issue on appeal

The issue on appeal was whether the parties had reached a further binding agreement about how the sum of £140,000 was to be shared between them.

Both parties were represented by solicitors and in correspondence between them containing proposals about how the sum of £140,000 was to be shared, both solicitors marked their letters "Subject to Contract" or "Without Prejudice and Subject to Contract". This correspondence culminated in Moneything's solicitors sending a letter (marked "subject to contract") to Joanne's solicitors enclosing a consent order, which contained a number of terms not previously discussed. Moneything's solicitors subsequently emailed Joanne's solicitors asking if they had any comments on the draft order, followed by a letter, saying that unless the draft consent order was agreed by a specified date, Moneything would apply to court for an order in those terms, which it did. In response, Joanne's solicitors asserted that there had been no binding settlement because the negotiations had been conducted "subject to contract".

Applicable principles

The Court of Appeal referred to the applicable principles as follows:

- Whether two persons intend to enter into a legally binding contract is to be determined objectively, but the context is all-important. In this case the most important feature of the context was the use of the phrase "subject to contract".

- The phrase "subject to contract" is a well-known phrase in ordinary legal parlance. Statements of its effect are legion.

- Once negotiations have begun "subject to contract", in the ordinary way that condition is carried all the way through the negotiations.

- Parties could get rid of the qualification of “subject to contract” only if they both expressly agreed that it should be expunged or if such an agreement was to be necessarily implied.

- Whether in such a case the parties agreed to enter into a binding contract, waiving reliance on the "subject to contract" term or understanding will again depend upon all the circumstances of the case, although the cases show that the court will not lightly so hold.

- If parties do intend to enter into a legally binding agreement, there is a different question that sometimes arises, namely whether the agreement they have reached is an incomplete agreement. Typically, this question arises where the parties have agreed some of the terms (or the main terms) of a contract, but have left other terms to be agreed later. This, however, is a different principle from the effect of negotiations "subject to contract".

Court of Appeal Ruling

The Appeal Court held that there was undoubtedly no express agreement that the "subject to contract" qualification should be expunged and that such an agreement could not be necessarily implied. It said the alleged offer and acceptance were each headed "without prejudice and subject to contract" and that it was also plainly contemplated that a consent order would be needed in order to embody the compromise, just as the earlier settlement agreement had been embodied in a formal signed contact. In the context of negotiations to settle litigation which are expressly made "subject to contract," the consent order is the equivalent of the formal contract. Nor had there been any performance of the putative contract. All that had happened was that correspondence had been exchanged.

The Appeal Court said that the judge below had seriously undervalued the force of the "subject to contract" label on the legal effect of the negotiations. He also failed to separate the two distinct questions (a) whether the parties intended to enter into a legally binding arrangement at all and (b) whether the agreed terms were sufficiently complete to amount to an enforceable contract. Almost all the points that he mentioned went to that second question, rather than to the first. In addition, the judge had failed to apply the correct test and had he applied the correct test, he could not reasonably have concluded that a concluded contract had been made. As the cases show, where negotiations are carried out "subject to contract", the mere fact that the parties are of one mind is not enough. There must be a formal contract, or a clear factual basis for inferring that the parties must have intended to expunge the qualification. In this case there was neither.

Comment

This case usefully restates the principles applicable to negotiations conducted “subject to contract” and is a reminder that once negotiations have begun "subject to contract", that condition is carried all the way through the negotiations and parties can only get rid of the qualification of “subject to contract” if they both expressly agree that it should be expunged or if such an agreement can be implied. Whether parties agreed to enter into a binding contract, waiving reliance on the "subject to [written] contract" term or understanding will depend upon all the circumstances of the case, although the cases show that the court will not lightly so hold.

Readers who are interested in this area of law may also see the Hong Kong judgment in Carrier Hong Kong Ltd v Dickson Construction Co Ltd [2005] HKEC 1581, a case handled by Deacons, where the arbitrator and the Court upheld a contract even though the phrase “subject to contract” had been used in some of Carrier’s letters.

Outcome Related Fee Structures for Arbitration

Justin Yuen

Currently, Hong Kong lawyers are prohibited from charging outcome related fees in arbitration, other than pursuant to

third party funding arrangements (for more information about third party funding, please see the article in our September 2017 newsletter). On 17 December 2020, the Outcome Related Fee Structures for Arbitration Sub-committee of the Law Reform Commission (Sub-committee) published a consultation paper proposing changes to Hong Kong law to enable lawyers to use outcome related fee structures (ORFS) for arbitration taking place in and outside Hong Kong, with the objective of maintaining Hong Kong's status as one of the world's top arbitral seats and to enable it to compete on an even playing field with other leading arbitral seats which allow some form of ORFS. The Sub-committee's view is that such fee arrangements are attractive to clients for many reasons, including financial risk management, access to justice, and a general desire that their lawyers share the risks inherent in litigating or arbitrating a claim.

What is an ORFS?

An ORFS is an agreement between a lawyer and client, whereby the lawyer advises on litigation or arbitration proceedings (Proceedings) which are contentious and the lawyer receives a financial benefit if those Proceedings are successful within the meaning of that agreement. For the purposes of the Consultation paper, ORFS include CFAs, DBAs and Hybrid DBAs, which are as follows:

CFA: Conditional Fee Arrangement - An agreement, pursuant to which a lawyer agrees with their client to be paid a success fee in the event of the client's claim succeeding, where the success fee is not calculated as a proportion of the amount awarded to or recovered by the client. CFAs include arrangements where (a) the lawyer charges no fee during the course of the Proceedings, and is paid only the success fee if the client's case succeeds (also known as "no win, no fee" agreement); or (b) the lawyer charges a fee during the course of the Proceedings, either at the usual rate or at a discounted rate, plus the success fee if the client's case succeeds (also known as a "no win, low fee" agreement).

DBA: Damages-based Agreement - An agreement between a lawyer and client, whereby the lawyer receives payment only if the client is successful, and where the payment is calculated by reference to the outcome of the Proceedings, for example as a percentage of the sum awarded or recovered.

Hybrid DBA: Hybrid Damages-based Agreement - An agreement between a lawyer and client whereby the lawyer receives both fees for legal services rendered (typically at a discounted hourly rate) and a payment that is calculated by reference to the outcome of the Proceedings, for example as a percentage of the sum awarded or recovered if the client is successful.

As well as recommending permitting the use of ORFS for arbitration for lawyers, the Sub-committee makes recommendations on the operation of CFAs, DBAs and Hybrid DBAs, including the following:

CFAs

- lawyers should be permitted to use CFAs in arbitration seated both in and outside Hong Kong. "Arbitration" should have the meaning given to it in s.98F of the Arbitration Ordinance, and include the following proceedings under that Ordinance: (i) court proceedings; (ii) emergency arbitrator proceedings; and (iii) mediation proceedings.

- Where a CFA is in place, any Success Fee and After the Event (ATE) Insurance premium agreed by the claimant with its lawyers and insurers respectively should not be recoverable from the respondent.

- Where a CFA is in place, there should be a cap on the Success Fee which is expressed as a percentage of normal or "benchmark" costs. The Sub-committee has invited proposals on what an appropriate cap should be, up to a maximum of 100% and also on whether barristers should be subject to the same or a different cap and, if different, what the cap should be, up to a maximum of 100%

DBAs

- Where a DBA is in place any ATE Insurance premium agreed by the claimant with its insurers should not be recoverable from the respondent.

- There should be a cap on the DBA Payment, which should be expressed as a percentage of the "financial benefit" or "compensation" received by the client. The cap should be fixed after consultation.

- Clients should be able to agree, on a case by case basis, whether:

  (a) the DBA Payment (and thus the DBA Payment cap) includes barristers' fees; or

  (b) barristers' fees would be charged as a separate disbursement outside the DBA Payment.

- To the extent that barristers can be, and are, engaged directly, this could also be arranged via a separate DBA between client and barrister. In such circumstances, a solicitor's DBA Payment plus a barrister's DBA Payment in relation to the same claim or Proceedings should not exceed the prescribed DBA Payment cap.

Hybrid DBAs

- In the event that the claim is unsuccessful (such that no financial benefit is obtained), the Sub-committee invites submissions as to:

  (a) whether the lawyer should be permitted to retain only a proportion of the costs incurred in pursuing the unsuccessful claim;

  (b) if the answer to (a) is "yes", what an appropriate cap should be in these circumstances; and

  (c) if the answer to (a) is "no", whether the relevant regulations should provide that, if the DBA Payment is less than the capped amount of irrecoverable costs, the lawyer is entitled to retain the capped amount of irrecoverable costs instead of the DBA Payment.

All

- A CFA, DBA, or Hybrid DBA should specify whether, and if so in what circumstances,

  (a) a lawyer or client is entitled to terminate the fee agreement prior to the conclusion of arbitration; and if so

  (b) any alternative basis (for example, hourly rates) on which the client shall pay the lawyer in the event of such termination.

The Sub-committee has also invited submissions on a number of matters, including the safeguards to be put in place in the professional codes of conduct and regulations, whether personal injury claims should be treated differently from other claims in arbitration and whether any additional category/ies of claim should be treated differently from other claims that are submitted to arbitration, and what should be the relevant method and criteria for fixing "Success Fees" in CFA.

The consultation period ends on 16 March 2021 and we shall provide further updates once the Sub-committee has issued its further recommendations.

UK Supreme Court rules on insurance policy wording for business interruption losses due to COVID-19

KK Cheung

A recent UK Supreme Court Judgment, the Financial Conduct Authority v Arch Insurance (UK Ltd) & Ors [2021] UKSC 1, clarified whether a variety of insurance policy wordings cover business interruption losses resulting from the COVID-19 pandemic and public health measures taken by UK authorities in response to the pandemic from March 2020.

Background to the appeal

The proceedings had been brought by the Financial Conduct Authority (FCA) under the Financial Markets Test Case Scheme (Scheme) pursuant to an agreement made with eight insurance companies to resolve issues of general importance on which immediately relevant and authoritative English law guidance was needed. As provided for under the Scheme, the case was heard by a court consisting of a High Court judge, sitting with a Court of Appeal judge, (Court). In the proceedings the FCA represented the interests of policyholders and two groups of policyholders had also intervened in the proceedings.

The Court considered 21 sample insurance policy wordings and accepted many of the FCA's arguments about the effect of these wordings, but the FCA appealed on certain issues on which it had not succeeded, as did some interveners. Six insurance companies (Insurers) appealed against the decision of the Court on other issues and also responded to the

FCA's appeal. Due to the importance and urgency of the issues raised, the appeals proceeded directly to the Supreme Court under the "leapfrog" procedure, bypassing the Court of Appeal.

Issues before the Supreme Court

The Supreme Court had to decide the following issues:

(i) the interpretation of "disease clauses" (which cover business interruption losses resulting from any occurrence of a notifiable disease within a specified distance of insured premises);

(ii) the interpretation of "prevention of access" clauses (which cover business interruption losses resulting from public authority intervention preventing access to, or the use of, business premises) and "hybrid clauses" (which contain both disease and prevention of access elements);

(iii) the question of what causal link must be shown between business interruption losses and the occurrence of a notifiable disease (or other insured peril specified in the relevant policy wording);

(iv) the effect of "trends clauses" (which prescribe a standard method of quantifying business interruption losses by comparing the performance of a business to an earlier period of trading);

(v) the significance in quantifying business interruption losses of effects of the pandemic on the business which occurred before the cover was triggered (Pre-Trigger Losses); and

(vi) in relation to causation and the interpretation of trends clauses, the status of the decision of the Commercial Court in *Orient-Express Hotels Ltd v Assicurazioni Generali SpA (trading as Generali Global Risk)* [2010] EWHC 1186 (Comm) (Orient-Express).

The Supreme Court substantially allowed the FCA's appeal and dismissed the Insurers' appeal, holding as follows:

Disease clauses

These clauses provide insurance cover for business interruption loss caused by any occurrence of a notifiable disease at or within a specified geographical radius (typically 25 miles) of the insured's business premises. The Court took one of the Insurer's (Royal & Sun Alliance Insurance Plc (RSA)) clauses as an example, which provided cover for business interruption following any occurrence of a notifiable disease at the business premises and for occurrence of a notifiable disease within a radius of 25 miles of the premises. RSA contended that the clause only covered business interruption consequences of any cases of a notifiable disease which occur within a 25 mile radius of the insured premises and that any cases of disease occurring outside that area did not form part of the inured peril. Conversely, FCA contended that the clause should be read as covering business interruption consequences of a notifiable disease wherever the disease occurs, provided it occurs (meaning there is at least one case of illness caused by the disease) within the 25 mile radius. The Court interpreted the clause as covering business interruption losses resulting from COVID-19 (which was made a notifiable disease on 5 March 2020) provided there had been an occurrence (meaning at least one case) of the disease within the geographical radius. The Supreme Court accepted the Insurers' arguments that (i) each case of illness sustained by a person as a result of COVID-19 is a separate "occurrence"; and (ii) the clause only covers business interruption losses resulting from cases of disease which occur within the specified radius.

Prevention of access and hybrid clauses

Prevention of access and hybrid clauses specify a series of requirements which must all be met before the insurer is liable to pay. Some clauses apply only where there are "restrictions imposed" by a public authority following an occurrence of a notifiable disease. The Court held that this requirement is satisfied only by a measure expressed in mandatory terms which has the force of law. The Supreme Court rejected this interpretation as too narrow and held that an instruction given by a public authority may amount to a "restriction imposed" if it carries the imminent threat of legal compulsion or is in mandatory and clear terms and indicates that compliance is required without recourse to legal powers. The Supreme Court did not rule on whether individual measures satisfied this test but indicated that the argument is stronger in relation to some general measures, such as certain instructions in mandatory terms from the Prime Minister. The wording of one of the intervener's policies provided cover only where business interruption loss was caused by the policyholder's "inability to use" the insured premises. The Court held that this means complete and not merely partial inability to use the premises. The Supreme Court agreed that inability rather than hindrance of use must be established, but held that this requirement may be satisfied where a policyholder is unable to use the premises for a discrete business activity or is unable to use a discrete part of the premises for its business activities. The Supreme Court interpreted wording requiring "prevention of access" to the premises in a similar manner.

Causation

On the Supreme Court's interpretation of disease clauses (see above) i.e. that such clauses only cover the effects of cases of COVID-19 occurring within the specified radius of the insured premises, questions of causation were of critical importance i.e. what connection must be shown between any such cases of disease and the business interruption loss. A key question was whether business interruption losses consequent on public health measures taken in response to COVID-19 were, in law, caused by cases of the disease that occurred within the specified radius of the insured premises. The Court found that the relevant measures were taken in response to information about all the cases of COVID-19 in the country as a whole. The Supreme Court held, in agreement with the Court, that all the individual cases of COVID-19 which had occurred by the date of any Government measure were equally effective "proximate" causes of that measure (and of the public response to it). It was therefore sufficient for a policyholder to show that at the time of any relevant Government measure there was at least one case of COVID-19 within the geographical area covered by the clause. In reaching this conclusion, the Supreme Court rejected the Insurers' arguments: (i) that one event cannot in law be a cause of another unless it can be said that the second event would not have occurred in the absence of ("but for") the first; and (ii) that cases of disease occurring inside and outside the specified radius should be viewed in aggregate, so that the overwhelmingly dominant cause of any Government measure will inevitably have been cases of COVID-19 occurring outside the geographical area covered by the clause. The Supreme Court explained why the "but for" test of causation was sometimes inadequate and that there can be situations (of which the present case was one) where a series of events all cause a result although none of them was individually either necessary or sufficient to cause the result by itself. The Supreme Court rejected the "weighing" approach as unworkable and unreasonable. In relation to the prevention of access and hybrid clauses, the Supreme Court held that business interruption losses are covered only if they result from all the elements of the risk covered by the clause operating in the required causal sequence. However, the fact that such losses were also caused by other (uninsured) effects of the COVID-19 pandemic did not exclude them from cover under such clauses.

Trends clauses

Almost all the policy wordings contained "trends clauses" which provide for business interruption losses to be calculated by adjusting the results of the business in the previous year to take account of trends or other circumstances affecting the business in order to estimate as nearly as possible what results would have been achieved if the insured peril had not occurred. The Supreme Court held that these clauses should not be construed so as to take away cover provided by the insuring clauses and that the trends and circumstances for which the clauses require adjustments to be made do not include circumstances arising out of the same underlying or originating cause as the insured peril (i.e. in the present case effects of the COVID-19 pandemic).

Pre-Trigger Losses

The Court, subject to qualifications, permitted adjustments to be made under the trends clauses to reflect a measurable downturn in the turnover of a business due to COVID-19 before the insured peril was triggered. The Supreme Court rejected this approach. In accordance with its interpretation of the trends clauses, adjustments should only be made to reflect circumstances affecting the business which were unconnected with COVID-19.

Status of Orient-Express

The *Orient-Express* case concerned a claim for business interruption loss arising from hurricane damage to a hotel in New Orleans. The policy contained a trends clause with similar wording to those in the present case. A panel of three arbitrators accepted the insurer's argument that the cover did not extend to business interruption losses which would have been sustained anyway as a result of damage to the city of New Orleans even if the hotel itself had not been damaged. The Insurers had relied on this decision to support their arguments on causation of loss and the effect of the trends clauses in the present case. The Supreme Court concluded that the *Orient-Express* case was wrongly decided and should be overruled.

Comments

This judgment provides useful guidance to insurers who issue insurance policies relating to COVID-19. The Supreme Court's ruling on causation is also relevant to construction cases. When there is more than one delaying event in a construction project, it is sometimes difficult to determine the question of causation. It provides the legal basis to argue that the "but for" test of causation may not be adequate for applying to all situations.

Competition Law and the Construction Industry – Deacons' Services

Last year, there were a number of notable developments in competition law, as detailed in this article, several of which involve or are relevant to the construction industry. The Ocean Park case concerned proceedings against a company and its director for exchanging competitively sensitive information with a co-tenderer in a bidding exercise. A number of judgments were handed down in proceedings against contractors. One such judgment was the first ever pecuniary penalty judgment, which was against ten contractors who were found to have contravened the competition law by participating in a market sharing and price fixing agreement. The judgment is important, as it sets out the four steps that the Tribunal adopts to determine the amount of penalty to be imposed, including looking at any mitigating circumstances. Another judgment handed down last year was the first in which a director disqualification order was made. Again, this was a case involving contractors and individuals who were found to have participated in a price fixing and market sharing agreement in connection with the provision of decoration works. As noted in the article, non-compliance with the Competition Ordinance can be severe, including substantial fines and director disqualification and all businesses in Hong Kong should therefore review their business practices and company procedures to ensure they fully comply with the law.

Deacons' construction team is able to advise on competition law issues arising in the construction industry, formulate best practice policies and provide training and webinars to ensure compliance with competition law. This may become relevant in mitigating the liability of directors when the Court is considering what penalty should be imposed.

As well as lawyers experienced in all aspects of competition law, Deacons has its own in house competition economist. Please contact our team for further information about the services that they can provide.

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