DRN-3777745

The complaint

A limited company, which I'll call O, has complained about the settlement provided for a claim under its restaurant insurance policy with Accelerant Insurance Limited.

Mr D, as a director of O, has brought the complaint on its behalf.

What happened

In early March 2021, O made a claim under the policy with Accelerant, as its premises was flooded as a result of a burst mains water pipe outside the premises.

I understand there is also another claim for a flood from February 2020 with another insurer, which has not yet been finally settled either, but this decision is only about the March 2021 claim under the policy with Accelerant.

Accelerant appointed loss adjusters to liaise on the claim. The material damage claim has been settled, with repairs to the property completed around September 2021. However, there is a dispute about the settlement of the business interruption and stock value parts of the claim.

Accelerant said there would have been no turnover in any case from March 2021 to May 2021, as a result of Government restrictions which required restaurants to close due to the Covid-19 pandemic. It is not in dispute that there is no cover under the policy for business interruption losses caused by Covid-19. Restaurants were allowed to reopen in May 2021 and so O could have reopened then but for the flood damage. Accelerant therefore calculated the loss of profit for the period from 17 May 2021 to 14 September 2021. Accelerant calculated the expected turnover from 17 May 2021 to 14 September 2021 as being £52,471, based on the actual turnover from 4 August to 10 November 2020.

Having then deducted savings that had been made as a result of not being open, such as utilities and wages costs, including furlough payments O's employees received, and applying a rate of gross profit adjustment, Accelerant said the loss of gross profit for the period was £3,924. Accelerant also agreed to pay the cost of O's accountant for preparing the information it needed to assess the claim (of around £500). I understand this amount was paid in September 2021.

Accelerant also offered a further £646 for the period 14 September to 4 October 2021, which is when O could actually reopen. This amount is not accepted as being correct but O accepted it on an interim basis and it was paid in February 2022.
There is also a dispute about the settlement offered for contents and stock of wines and spirits. Accelerant says the wines and spirits were valued at £2,830.61, excluding VAT but were insured for £2,500; and contents should have been insured for just over £70,000 as that's what they are valued at but the limit of indemnity under the policy is £15,000.

Accelerant says the terms of the policy allow it to only pay the £15,000 and £2,500 limits.

Mr D is very unhappy with the settlement offered. He has made a number of points in support of his claim. I have considered everything he has said but have summarised only the main points below:

- He does not consider it fair to deduct the furlough payments. O topped up the furlough payments so staff received full pay and in any case, they had nothing to do with the claim for escape of water.
- Accelerant calculated its expected profit based on 2020 figures which were affected by the restrictions on how it could trade due to the Covid-19 pandemic. It would have been fairer to use 2019 figures when it was trading fully.
- It had started doing takeaways in 2021 shortly before the flood, which could have continued during the lockdown period if it were not for the flood, so it would have had some income the during that period, which should be taken into account.

Mr D has also stressed how difficult this time has been for him and the considerable toll it has had on his health and wellbeing.

One of our Investigators looked into the matter. He recommended that it be upheld in part and recommended the following:

1. That the furlough payments should not be deducted from the settlement, as it was not a sum saved as a result of the damage being claimed for. The Covid-19 pandemic was not related to this claim.
2. Accelerant should not use the dates from 2020 when turnover was zero (*i.e*. week ending 10 November 2020) due to Covid-19 restrictions to base any loss of profit calculation.
3. There was not enough evidence to establish that it was likely O could have operated a takeaway business to ask B to pay for estimated takeaway revenue during the lockdown in 2021.
4. Any underinsurance of the contents was a result of a qualifying breach under the Insurance Act 2015 ("the Act"), and the Act should be followed, which would mean not applying the average clause to the settlement offered for the contents. The Investigator assessed that as Accelerant would have charged a higher premium for the insurance if it had known the full value of the property insured, this would mean Accelerant should pay 72.25% of the value of the contents claim, rather than the lower amount offered, plus interest at our usual rate.
5. The underinsurance in respect of wines and spirits would likely not be a qualifying breach under the Act, as C had made a fair representation of the risk as the value of the wines and spirits was not very different from the true value of them. The Investigator therefore said the settlement offered for wines and spirits was reasonable.

O accepted the Investigator's assessment.

Accelerant accepted the Investigator's assessment in relation to the furlough payments, dates used to calculate business interrupt losses, wines and spirits settlement and the takeaway business. However, Accelerant does not accept that the Insurance Act 2015 applies to this policy or claim. It has made a number of points in response, which I have summarised below:

- It and O contracted out of the Insurance Act 2015. The average clause in the policy represents the bargain made between the parties and "*overzealous*" application of the Act would make the remedies specifically set out in the contract void, which cannot have been the intentions of the parties when entering the contract.

- This is a clear case of underinsurance, not a case about fair representation
- If the intention was that the Act applies for underinsurance, no average clauses would be included in the policy.
- It was for the brokers that sold the policy, to make sure it was at the right level for O's needs. To penalise Accelerant for the errors of the broker is not fair or reasonable.
- It is permitted to impose terms that are less advantageous than the remedy provided in the Act, subject to certain conditions. It has met those conditions.
- It is not just the premium that is relevant when underinsurance occurs; the reserves it sets and certainty it has about its exposure are undermined and it has a wide-reaching, damaging effect for insurers.

As the Investigator hasn't been able to resolve the complaint, it has been passed to me.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

I can see this has been an incredibly stressful time for Mr D, suffering two large claims to the business premises, within a relatively short time, as well as the Covid-19 pandemic which has had a huge detrimental effect on his business and him personally.

The policy provides cover for business interruption as a result of property damage and the claim has been accepted. The dispute is about the way the settlement has been calculated and I'll consider each part of the complaint about that separately.

Basis of gross profit calculation

The starting point is the policy wording. The policy provides cover for business interruption losses following damage to the insured property up to the sum insured. I have set out below the what I consider to be the relevant policy term about how settlement will be made:

> *"Basis of settlement*
>
> *Gross profit*
>
> *The insurer will pay as indemnity to the Insured the amount of their loss in respect of each item stated in the schedule as a result of loss of Gross Profit due to reduction in Turnover and/or Increased Cost of Working …*
>
> *less any sum saved during the Indemnity Period in respect of any charges and expenses of the business payable out of gross profit which cease or diminish in consequence of the Damage*
>
> *provided that adjustments shall be made as may be necessary to provide for the trend of the Business and for variations in or other 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 they may be reasonably practicable the results which but for the Damage would have been obtained during the relative period after the Damage".*

O was already closed as a result of Government restrictions on the hospitality industry when the insured damage happened. So it would not have had any income from March 2021 to 17 May 2021, even if the damage had not happened (there was the possibility of takeaway

income which I'll address later). As the basis of settlement wording above allows Accelerant to make adjustments for the trend or other circumstances affecting O's business, I think it is fair for Accelerant to assess that there was no loss from the date the escape of water happened until 17 May 2021, when O could have reopened if it were not for the damage to its premises.

O says the usual expected revenue should be based on figures from May 2019, not May 2020, as its usual income would have been affected by the ongoing pandemic in 2020. However, the revenue would have been affected in 2021 due to the ongoing pandemic as well. The clause above means Accelerant was entitled to adjust the figures to allow for the impact of Covid-19, including the Government restrictions which would have meant O would have had to close for the period March to May 2021 and then operate under post-lockdown conditions, when calculating the expected turnover for that period. It seems to me that the figures from 2020 are likely to be reflective of the conditions that O would have been operating under if it had been able to open in May to October 2021 and so as far as reasonably practicable, is a good estimation of the revenue it could expect to have made in that period but for the flood.

However, having said that I do think the week ending 10 November 2020, which was a period when restaurants were required to close again, should not be included in those calculations. So I think Accelerant should recalculate the expected revenue without including this week. I am pleased that Accelerant has agreed to this already.

Furlough payments

Gross profit is defined in the policy as being: "*The amount by which the sum of the Turnover and the amount of the closing Stock shall exceed the sum of the amount of the opening Stock and the amount of the Specified Working Expenses*".

Accelerant says that the policy provides indemnity for loss of gross profit less any sum saved during the indemnity period for costs and expenses, that may cease or be reduced as a result of the insured event. So effectively, it covers the actual loss of profit.

The damage in this instance, which gave rise to the claim was the escape of water. The Covid-19 restrictions and Government furlough payments were not a result of this claim. The furlough payments were not paid to O as a result of the damage and so should not be deducted from the settlement. Again, this has now been agreed and I think that is reasonable.

Takeaway

O's accountant said it could have earned around 40% of its usual revenue if it had continued the takeaway business through the lockdown and this should be added to the expected turnover used to calculate O's loss.

The Investigator asked O for evidence of the takeaway business. It provided evidence of one takeaway order in early March 2021 and that is had a supply of takeaway boxes. However, O also said that it always had a supply of takeaway boxes, for customers who had eaten in and wanted to take food home with them.

Overall, I agree with the Investigator that there is not enough evidence that O would have been running a takeaway service during the lockdown period, if it were not for the water damage.

Underinsurance and The Insurance Act 2015

Accelerant says O was underinsured, as the sum insured for contents under the policy was significantly less than the true amount. The policy schedule sets out that O's sum insured for contents was £15,000, stock £4,000 and wines and spirits £2,500. The stock sum insured was considered adequate. However, the wines and spirits on site were valued at £2,830.61 excluding VAT, and Accelerant valued the contents at just under £61,000 excluding VAT. Because of this, Accelerant applied the average clause in the policy which says that where the value of property is found to be more than the sum insured, a policyholder is only entitled to claim a proportion of the sum insured:

> "*Basis of Settlement clauses*
>
> *1)Average*
>
> *If the Property covered by the policy shall at the time of the Damage be collectively of greater value than the Sums Insured then the Insured shall be considered as being their own insurer for the difference and shall bear a rateable share of their Damage accordingly…*

I have therefore considered whether it's fair and reasonable for Accelerant to apply the average clause.

O policy is a commercial one so the law that applies here is the Insurance Act 2015. When considering a complaint where underinsurance is alleged, before considering the policy terms, I must first consider the Act.

The Act codifies the commercial customer's duty to make a fair presentation of the risk to the insurer. In order to fulfil a fair presentation of risk, the Act says a commercial policyholder must disclose everything they know, or ought to know, that would influence the judgment of an insurer in deciding whether to insure the risk and on what terms.

So, I've first considered whether O made a fair presentation of the risk.

O says it purchased the business with trade contents in the sum of £70,000 included. O says it asked for higher cover than £15,000. (A separate complaint has been addressed to the broker that sold the policy.) However, as the sum insured was set at £15,000, when O knew the value of the contents was significantly higher, I am satisfied that O did not provide a fair representation to the risk when the policy was first taken out.

The Act sets out the remedies available to Accelerant if O breached the duty to make a fair presentation of the risk. For deliberate or reckless breaches, the Act entitles Accelerant to avoid the policy and decline all claims. Accelerant has accepted the claim, so I don't think it considers O made a deliberate or reckless breach. And I do not think it would reasonably be considered deliberate or reckless either. For all other breaches, the remedy available to Accelerant depends on what it would have done had a fair presentation been made.

The Investigator asked Accelerant whether it would still have offered the insurance and if so, whether the premium charged would have been more, if it had known the true value of the contents and wines and spirits.

Accelerant provided evidence that it would have still offered the same policy but would have charged £971.54 for the policy, rather than £701.22 for the policy, if it had known the true value of the contents. (This is slightly different than the Investigator calculated it at, as he said £970.54).

Under the Act, where an insurer has shown that it would have charged a higher premium if the correct information had been provided, it allows the insurer to settle the claim on a proportionate basis based on the proportion of premiums that were paid, compared to those that should have been paid.

Based on the evidence about the premium that would have been charged, O paid 72.18% of the required premium. Therefore, under the Act, Accelerant would be required to settle the claim for contents at 72.18% of its value.

The correct value of the wines and spirits was not very different from the actual value and I agree with the Investigator overall that C made a fair representation of the risk in relation to the wines and spirits, so this would not be a qualifying breach under the Act. Given this, I'm satisfied it was fair to pay the sum insured for wines and spirits.

Contracting out of the Insurance Act

In this case Accelerant says the Insurance Act 2015 doesn't apply to this contract and the "*average*" clause set out above applies and permits it to limit the sums paid for wines and spirits to £2,500 and contents to £15,000 being the maximum sums insured on the policy schedule (less applicable excesses). Accelerant has therefore settled the contents claim at around 21% of its value.

It is not uncommon for policies such as this to include an average clause. And Accelerant says it is permitted to apply the average clause and contract out of the Act, because the policy term is clear in the documents it's provided to the customer. It also says that the broker that sold this policy to O is experienced in these policies and would be aware of these kind of policy terms; it would be for the broker to make this clear to the customer.

Accelerant also says that it is a settled principle prior to the Act that underinsurance is not a matter of misrepresentation or non-disclosure to be remedied by avoidance but an issue dealt with by average. The terms of the policy which provide for average as a remedy for underinsurance should be respected, as a failure to disclose the correct value of the stock to be insured may not be a question of fair presentation at all, and this is the bargain the parties made. Accelerant says it is being asked to compensate for mistakes made by the broker, which is unfair and unreasonable.

I am not persuaded that the Act is not relevant to issues of underinsurance. As Accelerant has acknowledged the case law it relies on to support this pre-dates the Act.

Section 17 of the Insurance Act 2015 sets out the requirements for insurers where they wish to contract out of the Act. It states as follows:

> "*The transparency requirements*
>
> *(1) In this section, "the disadvantageous term" means such a term as is mentioned in section 16(2).*
>
> *(2) The insurer must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into or the variation agreed.*
>
> *(3) The disadvantageous term must be clear and unambiguous as to its effect.'*

16. 2 of the Act states:

"16 (2) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects any of the other matters provided for in Part 2, 3 or 4 of this Act than the insured would be in by virtue of the provisions of those Parts (so far as relating to non-consumer insurance contracts) is to that extent of no effect, unless the requirements of section 17 have been satisfied in relation to the term."

It is clear that O would be disadvantaged by the application of the average clause compared to the remedy available to Accelerant under the Act (as demonstrated by the calculations above).

Page 3 of the policy sets out the duties on the policyholder of making a fair representation of the risk in accordance with the Insurance Act 2015 and the remedies available to Accelerant in the event there has not been a fair presentation of the risk, which are all also in line with those set out in the Act.

The average and stock clauses are then in the material damage section of the policy
I do not consider that the inclusion of the average and stock clauses is sufficient to draw a policyholder's attention to the fact these are disadvantageous clauses and that Accelerant is intending to contract out of the Act by including them.

Accelerant also states that it is for the broker, with their experience and prior knowledge of these types of terms, to have advised O properly. There may be a case to answer by the brokers, however, in this decision I am asked to consider whether Accelerant has acted fairly and reasonably and in line with its obligations as an insurer. The Act requires the insurer to take sufficient steps to draw the disadvantageous term to the insured's (or the broker acting on their behalf's) attention. I do not think Accelerant has met the requirements under the Act. In accordance with the Act, the average clause therefore has no effect.

So as I'm not satisfied Accelerant has done enough to fulfil the requirements of the Insurance Act in relation to contracting out, I don't think it's reasonable for it to rely on the average clause in the policy to settle this claim. For this reason, I intend to require Accelerant to settle the claim in line with the Act, rather than the average clause. I've calculated this to be a settlement of 72.18% of the total value. Interest should also be added to any payment due as a result of this.

I think interest should be paid from the date the claim this amount should have been paid. The rest of the contents claim was settled (based on the sum insured) as a result of the loss adjuster's report dated 21 June 2021, so it would be shortly after that report.

My final decision

I uphold this complaint and require Accelerant Insurance Limited to do the following:

1. Reassess the claim for business interruption losses using the period May to 4 November 2020, as a basis for the expected revenue from 17 May to 4 October 2021, and without making deductions for furlough payments, together with interest at 8% simple per annum from the date the disputed amount was first paid to the date of payment.
2. Pay 72.18% of the total claim value for contents (less the amount already paid for contents, which I understand is £14,750), together with interest at 8% simple per annum, from the date the disputed contents claim payment was made to the date of payment.

Under the rules of the Financial Ombudsman Service, I'm required to ask O to accept or

reject my decision before 8 March 2023.

Harriet McCarthy
Ombudsman