DRN-3978584

The complaint

Mr S, trading as an enterprise, complains about the settlement, by Hiscox Insurance Company Limited, of his business interruption insurance claim, made as a result of the COVID-19 pandemic.

What happened

The following is intended only as a brief summary of events. Additionally, whilst others have been involved in the events and communications, I have just referred to Mr S and Hiscox for the sake of simplicity.

Mr S operates a gunsmith / gun trader business and held industry specific commercial insurance underwritten by Hiscox. This complaint actually relates to claims made under both the 2019 to 2020 policy and the 2020 to 2021 policy. As such, the complaint relates to separate actions. However, given the stage this complaint has reached, the similarity between the circumstances and policy terms for each, and the size of the claim compared with the limits on awards the Ombudsman Service can make, I feel it is sensible to consider this as one complaint.

The policies provided cover for a number of areas of risk. And when Mr S's business was impacted by the COVID-19 pandemic, initially in March 2020, he claimed under the business interruption section of the policies.

After initially declining the claim(s), Hiscox ultimately agreed that part of Mr S's claims were covered. Essentially, Hiscox accepted that during the three nationwide lockdowns, there had been an inability to use a discrete part of Mr S's business due to restrictions imposed by a public authority as a result of the occurrence of COVID-19. However, Hiscox said this was limited to the part of Mr S's business related to gun sales. And that the other part of Mr S's business, which related to servicing and repairs of guns was not subject to this restriction.

Due to Hiscox having made an interim payment to Mr S during the course of the claims, Hiscox said that it had already paid more than it calculated was due to him. Hiscox did not seek to recover any of this apparent overpayment though.

The gun sales portion of Mr S's business only accounted for about 10% of the business' revenue though, so effectively only 10% of Mr S's claims were met. And he was not happy with this. Mr S was also not happy with all of the deductions that had been made from the settlement. And he was unhappy with the service he had received during the course of the claims. Hiscox did not change its decision on the settlement, and actually explained that it had overpaid Mr S based on its calculations. But Hiscox did apologise for the level of service and offered £300 compensation for this.

Mr S remained unhappy and brought his complaint to the Ombudsman Service. Since then, Hiscox has increased the claims settlement slightly by adding interest to the sums, and has increased the £300 compensation to £500.

Our Investigator thought Hiscox had acted reasonably when limiting the settlement of the

claims to the sales part of Mr S's business. He did not think that there was an inability to use Mr S's business premises for the purpose of servicing and repairs that had been caused by a restriction imposed by a public authority.

Our Investigator also thought it was reasonable for Hiscox to deduct the money Mr S had received through the Coronavirus Job Retention Scheme ("furlough"), but that it was not fair for Hiscox to deduct money received through the Self-Employment Income Support Scheme ("SEISS"). And our Investigator thought interest should be added to the settlement and that Hiscox should pay Mr S the compensation for delays and customer service issues.

Hiscox did not agree that it was unfair to deduct the SEISS payments from the settlement. Mr S did not agree that it was reasonable to limit the settlement to only the sales part of the claim. As our Investigator could not resolve the complaint, it was passed to me for a decision.

I issued my provisional decision on 27 July 2023 and invited both parties to provide me with any additional comments or evidence they wished me to consider. The following is an extract from my provisional decision:

> "Non-sales related profit
>
> Mr S's main concern is the limitation of the settlement of his claims to only the sales revenue stream. He has said that he was unable to operate his business anywhere other than the business premises, all of his customers and suppliers had been closed, and that the Government had told all non-essential businesses to close.
>
> In considering whether Hiscox has acted fairly and reasonably, it is first necessary to think about what the policies covered. The policies contained numerous clauses providing cover in different circumstances.
>
> However, it seems clear that the clause most likely to provide cover did so on the following terms:
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> > "We will also insure you for your loss of gross profit up to the limit stated in the schedule as applicable resulting solely and directly from an interruption to your business caused by the following:…
> >
> > > your inability to use the business premises due to restrictions imposed by a public authority following:…
> > >
> > > > ii. an occurrence of any human infectious or human contagious disease an outbreak of which must be notified to the local authority"
>
> This is the term that the claim has been partially settled under and that most closely fits the circumstances. The term is a composite one, and each element of it must have happened in order for the claim to be met.
>
> Put simply these elements are:
>
> 1. A relevant disease has occurred
> 2. This has led a public authority to impose restrictions
> 3. Which caused an inability for the premises to be used
> 4. And this has interrupted the business, leading to a loss of gross profit.
>
> COVID-19 is a relevant disease and this occurred. So, it is necessary to then

consider the other elements.

As a result of the COVID-19 pandemic, the Government introduced a number of restrictions. The main ones were those contained in the regulations that led to the national lockdowns. For the sake of ease, I will focus much of the following discussion on the first lockdown and the restrictions that were introduced in relation to this. Other restrictions and lockdowns had slightly different rules, but I do not consider the differences to be material to the current complaint.

In March 2020, the Government introduced a couple of sets of regulations. This included the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020. These imposed restrictions on the public and on certain businesses. Some businesses were listed as requiring to close. This included shops offering goods for sale, other than certain types of "essential" shops.

Mr S's type of business is not one of those specifically listed as being required to close by these regulations. It is though likely to be considered a "non-essential" shop. And Mr S has referred to the Government's announcement that non-essential shops should close as meaning his claim should be met.

However, the regulations mentioned above also said:

> "If a business referred to in paragraph (1) or (3) [as being one required to close] ("business A") forms part of a larger business ("business B"), the person responsible for carrying on business B complies with the requirement in paragraph (1) or (3) to cease to carry on its business if it ceases to carry on business A"

Hiscox considers that the sales part of Mr S's business is effectively "business A", and so the requirement to close non-essential shops only applies to this sales part of Mr S's whole business ("business B"). This was the part of the business "offering goods for sale". So, it is only in relation to this discrete part of the whole business that the inability to use the premises applies.

This position is supported by the findings of the Supreme Court in the case of The Financial Conduct Authority & Ors v Arch Insurance (UK) Ltd & Ors [2021] UKSC 1. This was the test case the industry regulator, the Financial Conduct Authority ("FCA"), brought to answer some of the business interruption insurance questions that arose in the face of the pandemic. In paragraphs 136 to 137 of its judgment, the Court said:

> "We…see no reason why different business purposes should not be distinguished if the relevant activities are capable of being conducted separately. We consider that the requirement is satisfied either if the policyholder is unable to use the premises for a discrete part of its business activities or if it is unable to use a discrete part of its premises for its business activities."

And paragraph 141:

> "We should add that the FCA accepts that there is only cover for that part of the business for which the premises cannot be used."

Hiscox has considered that the sales revenue forms a discrete part of Mr S's business activities. And it considers that it is only in relation to this part of the business that there was an inability to use the premises. I consider that it is reasonable to consider the sales activity as being discrete from the non-sales activity.

Different revenue streams have been identified and the non-sales activity seemingly requires specific and specialist skills.

So, it is necessary to consider whether there was an inability to use the premises for the other parts of Mr S's business. Mr S's business is largely focussed on specialist 'adaptation' of guns. (I have deliberately not specified what this is in this decision as this is not directly relevant, but might lead Mr S to be identifiable in a published final decision.)

I understand that particular materials are required for this, and that the suppliers of these materials were not able to provide these during the lockdown periods. Mr S has also said that the majority of his commercial customers had closed.

I can appreciate that these factors would have made it extremely difficult for Mr S to successfully operate this part of his business. However, the question is whether there was a restriction imposed which caused an inability to use the premises for this purpose.

It seems that rather than there being a restriction on the use of the premises, any problems with carrying out the business were due to the lack of customers and materials. The lack of custom isn't something that stopped the premises being used – there was just a lack of work to carry out. And the issues with supply would have potentially caused a hindrance of use of the premises, but would not have led to an inability of use. To refer back the Supreme Court, it said earlier in paragraph 136 of its judgment:

> "… an inability of use has to be established; not an impairment or hindrance in use."

I am sympathetic to Mr S's position here. He has lost out due to reasons outside of his control. However, his policies – like all insurance policies – only cover specific events. If one of those events has not taken place, the policy will not provide cover. And it is not fair or reasonable to require an insurer to settle a claim for an event it has not agreed to cover.

In the current case, I am not currently persuaded that there was an inability of use of Mr S's premises for the discrete purpose of non-sales related business. So, it follows that I consider Hiscox acted fairly and reasonably when limiting his claim settlements to sales related gross profits.

Furlough and SEISS

Mr S is also unhappy that Hiscox deducted money received from the Government through furlough and SEISS payments from the settlements of his claims.

Before discussing Hiscox actions here, it is helpful to set out some of the background to these schemes. The Government provided financial support to businesses during the pandemic via a number of different schemes. These included furlough, SEISS and also a range of other grants - Local Authority Grant, the Small Business Grant and the Leisure/Retail/Hospitality grants, etc. Whilst there were differences between these 'other grants', for the sake of simplicity, I will refer to them collectively as "business support grants".

In 2020, the FCA, HM Treasury, a range of insurers and the Association of British Insurers, ("ABI") made a number of statements particularly in relation to these business support grants. They confirmed that how these grants were treated for tax

purposes was not determinative of how they should be treated for insurance claims. And that, ultimately, insurers should not be deducting the amount of these grants from claim settlements. Hiscox has agreed not to deduct money received from business support grants from settlements.

However, no such statements were made in relation to furlough or SEISS. And Hiscox considers that payments through these schemes are deductible from claim settlements.

Hiscox's position on furlough is directly supported by the judgment in Stonegate Pub Company v MS Amlin and Others [2022] EWHC 2548 (Comm) ("Stonegate"). This judgment, in part, considered whether furlough payments should be deducted from relevant business interruption insurance claims.

The judge in Stonegate determined that furlough payments were deductible from the relevant claim settlement, saying at para 270:

> "...I hold that the CJRS [furlough] payments did reduce costs payable out of Turnover and are to be taken into account under the savings clause."

His findings were made based partly on the fact that furlough payments were paid to businesses by the Government to cover part of the cost of paying employees' wages. They could not be used for any other purpose (albeit the timing of the relevant payments may have meant businesses had already paid staff, and the furlough payments acted as a 'refund' of these amounts). Paying employees their wages is an expense a policyholder, including Mr S, would normally have. As a result of the furlough payments, these policyholders saved on having to pay these wages.

The judge explained that the policy involved in the judgment set out that where any costs normally payable out of 'Turnover' were reduced as a result of the insured event, it was fair to deduct these. Mr S's policy provided cover for loss of gross profit and defined this as:

> "The sum produced by applying the rate of gross profit to any reduction in income during the indemnity period plus increased costs of working necessarily and reasonably incurred by you for the sole purpose of minimising the reduction in income to your business during the indemnity period but not exceeding the amount of income saved less any business expenses or charges which cease or are reduced."

This doesn't specifically require that the reduction in expenses or charges be as a result of the insured event – albeit that is likely to be a reasonable requirement. Regardless, the reason for Mr S's claim was – in simple terms – the COVID-19 pandemic. The Government introduced the furlough payments scheme as a result of this pandemic. So, it follows that the saving on Mr S's normal expenses was a consequence of the cause of his claim.

Based on this, it seems clear that Hiscox was contractually entitled to calculate Mr S's settlement taking into account the furlough payments being a saving – i.e. to deduct these from the settlement.

The judge in Stonegate considered not only the contractual position presented by the policy in the court case, but also the principle of indemnity and associated doctrine of subrogation. This is the basis which insurance, largely speaking, works. And effectively means that a claimant is only able to recover their losses and is not able to put themselves back in a better position that they otherwise would be. And where the

circumstances mean the loss the claimant has suffered has been reduced – such as because of a payment made by a third party – the insurer may be entitled to benefit from this reduction in loss.

The judge explained this in detail, but ultimately said there were three matters to consider in terms of a payment received from a third party. He set these out at paragraph 284 as:

> "(1) If a third party has made a payment which has eliminated or reduced the loss to the insured against which it had insurance, then, subject to the exception below, the insurers are entitled to the benefit of that payment, either in reducing any payment that they might have to make under the policy or, if they have already paid, by claiming the amount from the insured.
>
> (2) This will not be the case, however, if it can be established that the third party. In making the payment, intended to benefit only the insured to the exclusion of the insurers ...
>
> (3) In assessing the intentions of the third party payor, it does not matter whether that payor gave any thought to the position of insurers. A payment can still diminish the loss even if no such thought is given."

In terms of the first of these, the judge in Stonegate reasoned that furlough payments had reduced the employment costs to the same extent as the size of those payments. They were payable to businesses that were required, effectively, to pay their employees the corresponding amount either before or after the furlough payments had been made.

So, it is fair that an insurer, including Hiscox, deduct a sum paid under the furlough scheme from the settlement payable to policyholders, including Mr S. And I don't currently consider it would be fair or reasonable to conclude that Hiscox acted inappropriately in deducting the furlough payments Mr S received.

The judgment did not involve any consideration of SEISS, as no payments under this scheme were made to the parties. However, I do need to consider the reasoning of the judge when thinking about other payments, such as SEISS.

In considering whether SEISS payments had a similar effect to that set out above, it is necessary to determine whether they reduced the loss suffered by Mr S. This might either be because they reduced a cost that Mr S otherwise would have had to meet – as the furlough payments did with employment costs. Or because the SEISS payments were a form of income that limited the reduction in income Mr S's business experienced as a result of the pandemic.

Hiscox has said that furlough and SEISS are analogous. And that these are different from the business support grants. I do not think it is as clearly defined as Hiscox believes. So, I think it is helpful at this point to further consider these three types of Government funding, their similarities and differences.

All of these forms of Government support were introduced to support businesses through the difficulties created by the COVID-19 pandemic. All needed to be reported as "income" on the relevant tax returns. However, the judgment in Stonegate, with reference to Riley on Business Interruption Insurance (11th ed), suggests account classification in tax returns. etc. is not determinative for insurance purposes. And the FCA "Dear CEO" letter in relation to business support grants also stated that:

> "We therefore do not consider the Government's treatment of [business

> support grants] for tax purposes is a proper basis for insurers treating those payments as turnover under the policies"

So, I don't think the tax position in relation to these payments is particularly helpful or determinative.

One of the key differences between furlough payments and both SEISS and business support grants was that furlough payments were to be used specifically to cover part of the wages of employees. There was no restriction on the way the SEISS or business support grant payments could be used by the recipient, and these payments could be used in any way the business saw fit.

This is potentially quite significant when thinking about the definition of loss of gross profit above. Has an expense of the business been reduced by the receipt of SEISS where the payment wasn't required to be used for any specific expense? I'll return to this point below.

There are other differences between furlough and SEISS. These included the amount of money paid. The payment made under the first version of SEISS, introduced in April 2020, was the lower of £7,500 or 80% of the business' estimated profit for a three-month period.

Under the furlough scheme (at least as this applied to lockdown one), employers could claim a maximum of 80% of an employee's wages and this was also capped at £2,500 per month for each employee.

Initially, this looks fairly similar. For each individual 'working for' a relevant business – whether this be employee, sole-trader, or partner – the business essentially received 80% of their 'employment costs' capped at £7,500 for the three-month period. (I have deliberately used the term 'employment costs' here as this is what Hiscox consider SEISS to effectively be covering, but I shall also return to the issue of whether this is correct for a sole-trader or partnership.)

However, under the furlough scheme, businesses only received the payment if the relevant employee had ceased working. All that was required to claim SEISS was for an eligible business to have "been adversely affected by reason of circumstances arising as a result of coronavirus or coronavirus disease". A business need not have suffered either a £7,500 or 80% loss of profit in order to receive this sum from the Government. Later iterations of the scheme provided that a business suffering a 30% reduction in turnover would be entitled to a payment equivalent of 80% of expected profit. So, a self-employed person could continue working and their business could generate the majority of its normal income, yet would still be able to claim up to £7,500 under SEISS.

In some circumstances, SEISS payments may have been received by a business that was only moderately "adversely affected" by the pandemic and which meant that the business actually ended up receiving more money during the relevant period that it otherwise would have. Regardless of whether such a business may or may not have had an insurance policy which might provide cover for the situation, the SEISS payment would already have put them in a 'better position' than they otherwise would be. The indemnity principle did not apply to sole-trader businesses directly in relation to the government scheme though. This is a principle that relates to insurance. However, I think it is worth pointing this aspect of SEISS payments out, to demonstrate that the proper treatment of these is not a clearly defined matter.

In this regard, the SEISS scheme seems more akin to the business support grants. These were payments made to support businesses with their cashflow and fixed costs. A business need not have suffered a loss of expected income that matched the amount they received from the Government.

Yet, there were also differences between the SEISS and business support grants. To receive a payment under the business support grants, there was no need for that business to demonstrate that it had been adversely affected by the pandemic – albeit the businesses targeted by some of the grants were those in industries subject to specific restrictions and thus almost certainly affected. Businesses received a fixed sum, rather than one based on their profits. And the business support grants were administered by local authorities, whereas the SEISS (and furlough) were administered by HMRC.

These are only some of the features of these different types of government support. But, it is clear that there were some similarities and some differences between all three types. As I've also said, insurers (generally) have treated the money received through furlough differently to that received through business support grants, and this position has been supported respectively by the courts and the FCA, etc. The question in Mr S's case is how SEISS should be treated.

Thinking about the issues raised above around whether or not SEISS should be considered as being received to cover an 'employment cost' and so whether the receipt of this payment has reduced an expense of the business, with a sole-trader or partner, there is a limited distinction between the person and the business. Whilst some businesses would have used the money, either partially or wholly, to provide a personal income to the owner of the business, others would not. The money may have been spent on operating costs, invested into the business, or saved for use outside of the indemnity period.

Hiscox has made detailed arguments over the lack of separation between the 'person' and the 'business' in respect of a sole-trader/partner. Whilst I accept much of what Hiscox has said, there are scenarios where the money received through the Government support (either SEISS or business support grants) may have been spent in a manner that means there would not be a saving on an expense of the business that otherwise would have been incurred. For example, some businesses may have made the decision to increase spending on advertising to make up for the loss of business they incurred during the lockdown period.

Had it not been for the lockdown period, this advertising would not have been required, so this was a 'new' cost to the business but one which was met by the government support the business received. In such circumstances I don't think it could be argued that this was an 'employment cost' or that the support payment reduced an existing business cost.

On the other hand, if a sole-trader used the money from the Government support to pay for their personal expenses (food, household rent, etc.) the business would likely be using the money to cover the 'employment costs' of this person (noting that the business and individual are effectively one in the same). The individual would likely have needed to take this sum of money from the business even had there been no pandemic. So, this has reduced the expenses the business would otherwise have incurred.

So, it may be that in order to fairly assess whether or not SEISS payments can been considered by an insurer as reducing the expenses of the business, it is necessary to

assess what this payment has been used for.

This is supported to an extent by what the FCA said[1] about assessing government funding:

> "The insurer will need to assess this for some or all of each type of government support received by the policyholder with a case by case assessment. The assessment should consider:
>
> - the exact type and nature of the Government support
> - how the policyholder used this support
> - the type of policy and its precise terms, including any set methodology for calculating the value of a claim set out under the relevant section of the policy
>
> Some of these factors will be case and claim specific. Even where it is appropriate in principle to deduct these amounts, a single, uniform approach to deductions is still unlikely to be appropriate."

It should be noted that this statement was made prior to the judgment in Stonegate. However, I don't consider that this judgment fundamentally changes this situation. In order to assess whether or not a SEISS payment has reduced a loss by virtue of reducing a cost to the business, it must be established which cost has been reduced. And, whilst the Ombudsman Service's inquisitorial remit applies to complainants as well as respondents, it is ultimately for Hiscox to demonstrate that a cost or expense has been reduced in order to apply either the insurance contract or the doctrine of subrogation to the claim on this basis.

I am not persuaded that Hiscox has demonstrated that the SEISS payment received by Mr S has reduced any specific cost or expense. So, it follows that I do not consider it is fair or reasonable for this sum to be deducted from the settlement on this basis.

However, the other way of considering the SEISS payments is that they were a form of income. This is how they are considered for tax purposes, although the above comments from the Dear CEO letter, about this not being a proper basis for how they should be considered in terms of an insurance claim, should be noted.

The Ombudsman Service's understanding of what is fair and reasonable in relation to SEISS payments has been one that has evolved, much like the wider legal landscape around business interruption insurance claims. Previously, we have considered that an individual may not have considered a government grant, of the nature of those paid to businesses in relation to a novel situation such as the pandemic, to be "income".

However, as the judge in Stonegate referred to in paragraph 267 of the judgment, the clauses in Mr S's policy should be construed, if there is any room for argument, to accord with the basic principle that the policy was a contract of indemnity. He went on to say, albeit in relation to furlough payments, at paragraph 269:

> "It should, if possible – and in my view it clearly is possible – be construed so that those payments are taken into account under the savings clause."

[1] https://www.fca.org.uk/news/statements/non-damage-bi-settlements-deductions-relation-government-support

So, thinking about the principle of indemnity and the fact that insurance is, effectively, there to cover losses of a policyholder that can't otherwise be recovered, I need to consider whether it is fair for Hiscox to cover Mr S's loss of income where Mr S has received money from a different source. More precisely, I need to ask whether Hiscox's decision to deduct this sum from the settlement was fair and reasonable.

Thinking about the situation holistically, I am not persuaded that Hiscox considering the money received from SEISS to be income was unfair or unreasonable. And whilst it may not be considered insured income, the receipt of this money did provide Mr S with funds he otherwise would not have had and which acted to reduce the overall losses he sustained as a result of the pandemic.

So, for the purposes of Mr S's claims, I consider it was fair and reasonable for Hiscox to treat the SEISS payments as "a payment which has eliminated or reduced the loss to the insured against which it had insurance" – i.e. as income.

The second matter that the judge in Stonegate listed was whether the third-party making the payment intended to benefit only the insured to the exclusion of the insurers; i.e. whether the Government intended to benefit Mr S only and not Hiscox. If Hiscox deducts the SEISS payment from the settlement, the payment will have benefitted Hiscox in that it has reduced the sum it needs to pay Mr S.

The arrangements for SEISS were introduced under powers granted by sections 71 and 76 of the Coronavirus Act 2020. The arrangements were set out in Directions issued by the Government in April 2020. The Direction relating to SEISS said:

> "The purpose of SEISS is to provide for payments to be made to persons carrying on a trade the business of which has been adversely affected by the health, social and economic emergency in the United Kingdom resulting from coronavirus and coronavirus disease."

No comment was made about this payment being intended only to benefit the businesses receiving these sums though.

As I have noted above, the Treasury did make some later comments of its own about government grants. In a letter to the ABI[2], it said:

> "The principle of these grants is to provide emergency support and help businesses survive. The practice of making these deductions would mean that taxpayer funds are being channelled into savings for insurers, rather than supporting businesses to ride out the disruption brought on by this pandemic… I strongly encourage those insurers who are making these deductions to follow this example, to respect the spirit of these government support schemes, and to consider the difficulties being faced by businesses during this time."

However, this letter was issued in relation to discussions around the business support grants. Insurers, including Hiscox, agreed not to deduct payments from these grants from claim settlements. The letter did not reference, and was not in relation to a conversation concerning, furlough or SEISS.

Thinking about this in relation to the judgment in Stonegate, which was issued some

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2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/921682/EST_letter_to_Huw_Evans.pdf

time after these comments from the Treasury, the judge said in relation to furlough:

> "As to the intention of the Government in paying, Stonegate has not shown that this was with the intention of benefiting Stonegate alone to the exclusion of insurers."

There is no express statement by the Government to that effect. The Government did not indicate that the payment was being made only in respect of uninsured losses."

So, it does not seem the judge considered the Treasury letter to be relevant to furlough. And, given the Government hasn't said anything different in relation to SEISS than it did to furlough, it seems likely that the judge would not have considered the Treasury letter was relevant to SEISS either.

Taking these points into account, I don't think the payor (the Government) intended to benefit the insured (Mr S) only to the exclusion of the insurer (Hiscox). It follows that Hiscox can fairly and reasonably deduct the SEISS payments from the claim settlements.

The settlement calculation

However, it is necessary to also think about how Hiscox has deducted the SEISS payments from the settlements.

Hiscox has calculated the loss of profit suffered by Mr S and then deducted from this amount certain sums. Largely, these are the savings Hiscox considers Mr S to have made – on things like utilities bills. This makes sense as these are savings on costs that Mr S would have normally had to pay out of [his] profits. And this also makes sense for furlough payments; as these were in effect a saving on the wages normally payable to employees.

But, as above, I did not consider Hiscox has demonstrated that the SEISS payments Mr S received were a saving on a cost or expense he otherwise would have had to meet. I was satisfied that Hiscox can treat this money as effectively being income. But this means the deduction of this sum needs to have been made prior to the application of the rate of gross profit.

Hiscox has indicated that the appropriate rate of gross profit applied to SEISS has to be reflective of the actual rate of gross profit / costs incurred in generating this income. And as there were no costs directly associated with this income, the rate of gross profit is 100%.

Whilst I do appreciate the points Hiscox has made here, which do accord in many respects with common industry practice, I am not persuaded by its argument in the case of SEISS payments to Mr S.

This is because I don't consider it fair and reasonable to consider the SEISS payments exactly the same way as other income. Although I am satisfied these payments reduced the loss to the insured, and so can be deducted from the settlement, this was not money generated by the business' activities within the indemnity period. So, the cost of any activities within this period are not directly relevant to the cost of generating this money.

The Coronavirus Act 2020 Functions of Her Majesty's Revenue and Customs (Self-Employment Income Support Scheme) Direction set out how SEISS payments should be calculated (for the first version of the scheme). Paragraph 6.1 gave the

general formula for this, and then the Direction explained what each of the elements of that formula meant.

Essentially, this was based on the average business income of the individual over the previous three years. So, it is arguable that it is the average rate of gross profit for the business over this period that is most relevant to calculating the cost of generating this money.

However, this isn't necessarily fair either. SEISS payments were made to individuals, rather than to their businesses. For example, each partner of a partnership would receive a separate payment. Due to the lack of legal separation between, for example Mr S and his business, these payments can be seen as reducing the losses the business has experienced – for the reasons set out above. But the size of the SEISS payment is based on the amount of, effectively, net profit the business generated in previous years. It is this net profit of the business that forms, in simple terms, the trading profit of the individual (albeit the Direction included further specific details defining this trading profit).

This is essentially the reason for Hiscox's argument that the SEISS payment should be considered a saving on an expense; that the payment of the business' net profit to the individual sole-trader was an expense that was saved. I have set out above why I don't consider this is correct.

However, this situation does complicate how the SEISS payment should be considered in terms of the claim settlement. It is arguable that the SEISS payment was not "income" of the business, but was in fact a payment equivalent to "net profit". The calculation of the claim settlement as well as the reasons for making such a payment are different to the calculation of and reasons for the SEISS payment. So, a direct correlation is not appropriate. But neither is a direct comparison between this payment and the income generated by a business through its own activities during the period of the claim.

Taking all of this into account, I consider that the fair and reasonable way to account for SEISS payments in the claim settlement is to consider them as income generated based on the rate of gross profit prior to the claim event. In Mr S's case, this was 56%.

I do recognise that there are shortcomings with this approach, and that this may not be the outcome a court would reach. But having considered all of the circumstances of the complaint, I am satisfied that this is the fair and reasonable outcome.

Also in terms of the settlement calculation, I note that Hiscox has only deducted a proportion of the payments received. This is because Hiscox has effectively separated Mr S's business into the sales and non-sales elements. It has only agreed to cover the losses in relation to the sales element, which for the reasons above I consider fair and reasonable. But it follows that only the savings and income received in relation to the sales element of the business should be taken into account when calculating the settlement. So, I consider this also to be fair and reasonable.

Lastly, I note that Hiscox has offered Mr S more than it calculated was due from the claims and has not sought to directly recover this sum. I have said that Hiscox should recalculate the settlement differently in relation to the SEISS. If, following this calculation, further settlement is due on the claims, it is reasonable that Hiscox take into account any overpayment already made. This may ultimately mean that no further payment is required to settle the claims in relation to this.

Claim handling / service issues

Hiscox, like all insurers, would have received a large number of claims at the same time relating to the pandemic. So, it is not overly surprising that it had difficulty providing the level of service that might reasonably be expected. I also appreciate that dealing with business interruption insurance claims is often complex and that this can take some time.

However, this does not change the fact that Mr S did not receive the expected level of service. Hiscox initially declined the claim in 2020, and it is clear that there were delays in making a final settlement offer between March and October 2021. Mr S has said that Hiscox also suggested he might be able to carry out the non-sales related business outside of the premises, when it seems clear this was not possible.

Hiscox has though already accepted that it should have handled the claim better, and has offered Mr S £500 compensation in total, as well as interest on the claim settlement in line with what I would direct it to pay.

Parts of this offer were made after the complaint was referred to the Ombudsman Service. So, this is a change in the outcome of the complaint as it was made. But I considered Hiscox's full offer here to be reasonable and agree it appropriately compensates Mr S for the issues experienced that were the fault of Hiscox.

I do appreciate that Mr S is unhappy with the fact Hiscox has limited his claims in the way that it did. But, for the reasons above, I consider that the majority of the decisions Hiscox reached in terms of his claims were fair and reasonable. So, whilst Hiscox's decisions may have caused Mr S distress, this is not something I consider Hiscox needs to compensate him for.

I also appreciate that this decision will be disappointing for Mr S, but I hope I've provided him with a thorough explanation of why I currently consider only a small part of the complaint should be upheld in the circumstances."

Both Mr S and Hiscox responded to my provisional decision.

Mr S considers that as a non-essential business he was told to close. He has also said that, as all of his customer and suppliers were shut, he was unable to open. And that he was sent home by the police on one occasion when he went to check on the security of his premises. Mr S is also unhappy that my provisional decision was that Hiscox were entitled to deduct the SEISS payments from the settlement of the claim.

Hiscox responded disagreeing with the settlement calculation part of the provisional decision. It said this would result in an over-indemnity as it effectively makes a deduction for costs and expenses that were not incurred. Hiscox said that if SEISS payments were equated to net profits, then it would not be necessary to make any adjustment for the rate of gross profit. And if SEISS is considered income, the actual costs (or lack thereof) incurred to generate this income should be relevant. Ultimately, it did not consider its existing approach was unfair or unreasonable.

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 am grateful for the parties for their submissions. I note that both my provisional and this

final decision are lengthy and go into some detail. However, as can be seen, the major issues remain disputed.

Mr S remains unhappy that his claim for losses relating to the non-sales part of his business have not been covered. He has asked how he could have stayed open.

I appreciate that Mr S would have had significant difficulties with operating this part of his business. It is likely he had very limited, if any, materials or customers. So, actually operating this business – especially profitably – may have been impossible. However, the issue at hand is not whether his business could have remained operational, but whether his insurance policy covers the circumstances.

No insurance policy covers every situation. And Hiscox provided a policy that insured against certain situations only. The unfortunate situation Mr S found himself in is not one that is covered by this policy (other than in relation to the 'shop' side of the business).

Mr S's policy provides cover where there was an inability to use his premises as a result of a restriction imposed by a public authority. A restriction imposed is either something that is or is anticipated soon to be legally binding.

The closure of all non-essential businesses was not something the Prime Minister ordered in his announcements, including those on 20 and 23 March 2020. And the regulations that followed did not say that all non-essential businesses should close. The businesses that were told to close were those listed in the relevant regulations, including non-essential shops. This is why the 'shop' part of Mr S's business is covered by the policy.

The 'repair' side of his business was not required to close though. Many non-essential businesses remained open and continued to operate, largely, as normal. Mr S's business may have had other difficulties with operating, but would fall into what the Courts referred to (in the FCA test case) as a Category 5 business. As the High Court said, at paragraph 335 of its judgment; "Category 5 consists of businesses not listed in the 26 March Regulations such as manufacturing, accountants, lawyers, recruitment agencies and construction. These businesses were not ordered to close and were thus permitted to remain open." Mr S's business would likely be akin to a manufacturing business and so was permitted to remain open.

And one of the reasons people were allowed to leave their homes was to go to work. I cannot answer for the police, however regulation 6(2)(f) of the Health Protection (Coronavirus, Restrictions) (England) Regulations 2020 gave the following as a reasonable excuse for a person to leave their home; "to travel for the purposes of work or to provide voluntary or charitable services, where it is not reasonably possible for that person to work, or to provide those services, from the place where they are living". So, Mr S and his staff going to his premises to carry out 'repairs' would have been a reasonable excuse for leaving their homes.

As such, I am satisfied that the non-retail side of Mr S business was not subject to a restriction imposed which meant there was an inability to use it.

In terms of the SEISS payments, I have explained in my provisional decision – as set out above – why I consider these are deductible from Mr S's claim settlement. And I have not been provided with anything to change my conclusions here. So have come to the same decision as in my provisional decision and it is fair and reasonable for Hiscox to deduct these payments from the settlement as they are "a payment which has eliminated or reduced the loss to the insured against which it had insurance".

As to how this should be considered in terms of the settlement calculation, i.e. at which point in the calculation the sum should be deducted, I do appreciate Hiscox's points. However, I am not persuaded to alter my provisional decision on this issue either.

It is helpful to refer back to what the policy wording says. The policy says cover it provided for:

> "The sum produced by applying the rate of gross profit to any reduction in income during the indemnity period … less any business expenses or charges which cease or are reduced."

Various terms are defined here, including the "rate of gross profit" as:

> "The percentage produced by dividing gross profit by your income during the financial year immediately before any insured damage."

The policy makes no mention of varying the rate of gross profit in relation to the period of indemnity. So, the required calculation is to apply the previous year's rate of gross profit to the reduction in income, less any reduction in expenses or charges.

Applying this formula without any adjustment isn't necessarily appropriate in all circumstances. And Hiscox has said that not taking into account the lack of costs involved in generating the SEISS payments results in an over indemnity for Mr S (at least in this aspect). Whilst I note Hiscox's comments here, I am not persuaded that it is fair and reasonable in this case to apply a rate of gross profit of 100% to the SEISS payments. I do not consider this to be a situation where this is within a range of potentially fair outcomes.

Whilst I have referred to there being an argument that a SEISS payment was in fact a payment equivalent to "net profit", I have said that a direct correlation is not appropriate. SEISS payments were not a direct replacement of the loss of profit a business suffered. As I have said, these payments were not based on the amount of loss the business had incurred and, provided the business had been adversely affected, the actual level of loss wasn't relevant to the size of the payment.

So, whilst they were calculated using the amount of profit a business had previously generated, the payments were not a replacement of lost profit as such. They were merely money that was paid to the business. As such, they should be seen more akin to income than profit. However, it should also be noted that they are not money paid in respect of Mr S's business carried out from his premises – which is effectively what the policy defines income as. And there were no expenses or charges associated with obtaining this payment that could cease or reduce.

These payments were not money Mr S generated direct through his business activities during the indemnity period. So, I do not consider it is appropriate to apply the cost of generating this money within the indemnity period. And that the fair and reasonable method of calculating this sum is to apply the terms above on the basis that the SEISS payments reduced the reduction in income Mr S's business achieved.

Putting things right

Hiscox should calculate any deduction of SEISS payments from the claim settlements on the basis that these reduced the reduction in income Mr S experienced. And the rate of gross profit from the financial year immediately before the cause of claim should be applied.

Hiscox should add interest to the claim settlement at a rate of 8% simple per annum, from the date interim payments ought to have been made to Mr S to the date of settlement. These

interim payments would have been made on a monthly basis starting two months after the claim was made. Hiscox is entitled to take into account any interim payments it has made when making this calculation.

Hiscox should also pay Mr S £500 compensation, if it has not already done so.

My final decision

My final decision is to uphold this complaint in part. Hiscox Insurance Company Limited should put things right as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 15 September 2023.

Sam Thomas
Ombudsman