DRN-4766999

The complaint

A limited company, which I will refer to as M, complains about the settlement of its business interruption insurance claim by Covea Insurance plc. The claim was made as a result of the COVID-19 pandemic.

What happened

The following is intended only as a brief summary of events. Additionally, although other parties and individuals have been involved in the events and correspondence, I have largely just referred to M and Covea.

M operates as a pub and held a commercial insurance policy underwritten partly by Covea. The policy provides cover for a number of areas of risk, including business interruption. In 2020, M's business was interrupted by the COVID-19 pandemic, including the government-imposed restrictions. So, M claimed under the policy.

Ultimately, Covea agreed to meet the claim. But has only agreed to a settlement of around £86,000. M considers this settlement should be around £267,000. And brought its complaint about the settlement of the claim to the Financial Ombudsman Service.

M's submissions, both before and after our Investigator had reached his opinion on the complaint are detailed and lengthy. Both parties are aware of these and I do not intend to repeat their detail here. Essentially though, M's complaint focusses on five points:

- How the fact that the year prior to the claim was a leap year, and so included 366 days, should factor into the settlement
- The deduction from the settlement of money received through the Coronavirus Job Retention Scheme ("furlough")
- The deduction from the settlement of other savings in wages
- The settlement of increased costs of working
- The lack of an adjustment for the trend of M's business.

Our Investigator's opinion was effectively that Covea had settled the claim fairly and reasonably in the circumstances. He considered that, as the indemnity period did not include 366 days, it was fair and reasonable to base the settlement on M's turnover without this additional "leap day". He thought it was reasonable to deduct the furlough payments and other wage savings in full, as this was money M had not had to pay out.

Our Investigator also considered that it was reasonable for Covea to only pay for 50% of the increased costs of working M had seemingly incurred, on the basis that M would continue to benefit from the measures taken. And that Covea had acted appropriately when not making an adjustment for the trend of M's business, as the policy set out how the settlement ought to be calculated – and did not include provision for this.

M disagreed with this outcome and so its complaint has been passed to me for a decision.

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.

Having done so, I am not upholding this complaint. I'll explain why.

As I have mentioned, M's submissions are detailed and lengthy. I would like to reassure M that I have considered these submissions in full. However, I will not be responding to each individual point or argument raised. This is not meant as a discourtesy to M, but rather reflects the informal nature of the Ombudsman Service. I appreciate M considers that I am obligated to respond to each of the arguments made, but I disagree. Whilst I have considered these, along with all of the circumstances of the complaint, my decision will focus on what I consider to be the key issues.

Additionally, M has made reference to a number of legal judgments from other jurisdictions, for example from courts in the USA. I have noted these. However, I do not consider them to be determinative. Both the Ombudsman Service and the contract of insurance are governed by UK law. Judgments in other jurisdictions can be useful where there is an absence of a UK judgment on a point or principle. They can indicate what a UK court might do in similar situations. But judgments from other countries do not, largely speaking, form part of the relevant law in terms of an Ombudsman's decision making.

The circumstances of M's complaint are that this was a business located in the UK, carrying out business in the UK, and the contract at the heart of the dispute was based on UK law. There does not appear, in my view, to be any reason for applying any principles of international law that are not already contained in UK law.

M's references to Article 1 of the First Protocol of the European Convention on Human Rights do not appear overly relevant to this complaint, given no direction is being made that a party to the complaint should be deprived of their property. M might argue that, by not paying the full sum it considers to be due under the policy, it is being deprived of its property. But, ultimately, I do not consider a further payment to be necessary, so this does not form part of its property.

Having said all of this, I have noted the general arguments and points made by M when citing foreign judgments, as well as those made both when citing UK judgments and more generally. I do not intend to address each point made though. As I have said, I will holistically focus this written decision on what I consider to be the key issues.

<u>The turnover</u>

M's policy with Covea sets out the cover provided and how a claim will be settled. Again, both parties are aware of the content of this, and it is not necessary for me to repeat this in any detail here.

Part of these terms say that a claim will be settled by paying the difference between the turnover during the indemnity period and the standard turnover. And the policy defines standard turnover as:

> "the turnover during that period in the twelve months immediately before the date of the damage which corresponds with the indemnity period"

The maximum indemnity period applicable to M's policy is 12 months. And this is the period that the claim settlement has been based on.

M's argument is essentially that, as its business was interrupted for at least 12 months, the standard turnover applicable to the claim – i.e. for the 12-month period prior to the interruption – is the amount the settlement should be based upon. And the fact that this period included a leap day is not relevant; it is the 12-month period regardless of how many days this consists of. Covea on the other hand have based the settlement on the fact the 12-month period of indemnity was 365 days.

As the term above says, it is the period in the previous 12 months which corresponds with the indemnity period that establishes the standard turnover. In this case, the indemnity period consisted of 365 days. So, the standard turnover is the equivalent 365 days from the previous 12 months. Had the indemnity period been less than the maximum, say a 30-day period, the standard turnover applicable to that claim would be the turnover generated in the equivalent 30-day period in the previous 12 months.

Ultimately, M is able to claim for its losses over a 365-day period. This is the number of days it was potentially impacted in the 12 months following the commencement of its claim. It would not be fair or reasonable to settle its losses based on what it was previously able to generate over a 366-day period.

Furlough

Our Investigator has provided an explanation to M of why it was fair and reasonable for Covea to deduct payments M received through the furlough scheme from the settlement. My understanding is that M now accepts this position.

However, for the sake of completeness, I will say that I agree with the Investigator's assessment on this point. M did, or ought to have, only claimed 80% of its employees' usual wages under the furlough scheme. This means that whilst M paid this 80% to its employees, the amount it paid was offset by the amount it received from the Government. And so, M effectively saved on having to make this payment itself. Meaning it is fair and reasonable for Covea to deduct this amount from the claim settlement.

This also accords with a previous final decisions issued by both myself and colleagues within the Ombudsman Service, at least one of which has been referenced by M. I have replicated some of the wording of this decision below, as whilst the Ombudsman Service makes decisions based on the individual circumstances of each complaint, the relevant circumstances here are similar.

Essentially, furlough payments were paid to businesses by the Government to cover part the cost of paying employees. 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 M would normally have. As a result of the furlough payments, M saved on having to pay these wages. So, I consider this can only reasonably be described as a saving on the business' expenses.

The reason for M'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 M's normal expenses was a consequence of the cause of its claim. Based on this, it seems clear that Covea was entitled to calculate M's settlement taking into account the furlough payments being a saving – i.e. to deduct these from the settlement.

I also note the judgment of the court in *Stonegate Pub Company v MS Amlin and others* [2022] EWHC 2549 (Comm), as well as other related judgments. In Stonegate, the court

considered whether the relevant policyholder in the case should have the furlough payments they received deducted from their insurance settlement. So, whilst the court made its judgment based on the particular terms of the policy etc. I do consider the judgment to be a relevant consideration in M's case.

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*."

The clause in question is similar to that in M's policy, so I think this judgment supports my own conclusion in this complaint. And I consider Covea acted fairly and reasonably by deducting the sum M received through the furlough scheme from the settlement.

Other wage savings

Furlough payments only accounted for 80% of a business' normal wages costs. Employers were left with the option of "topping-up" this amount with the remaining 20% and paying this to their employees. M chose not to do this. And Covea considers this a saving on its normal expenditure.

M has disputed the interpretation of the policy wording here. (Arguably, the same points also relate to the furlough issue above, but as I do not agree that they mean Covea acted inappropriately, I have only referred to them here.)

The policy wording says the settlement will be the difference in turnover less:

> "any sum saved during the indemnity period in respect of such of the charges and expenses of the business payable out of gross profit as may cease or be reduced in consequence of the damage."

M has raised arguments around the meaning of "saved", "charges", "expenses", and "payable". Generally speaking, I agree with M that, as these terms are not defined within the policy, they should be interpreted in line with their everyday meaning, taking into account the context provided by the rest of the policy. And that reference to dictionary definitions provides a good source for such an interpretation.

But whilst I agree with this, I don't agree that this means Covea should not be able to make the deduction it has.

I consider that the payment of wages is a normal expense that a business will have, that will likely be payable out of gross profit. Arguably, if a business is not profitable, it may still need to pay wages, but that isn't the circumstance here, so I have not considered this further. I also consider that by not making the normal payment of wages that it otherwise would have, a business will have saved on this expense. I find it difficult to agree that a reasonable person, with all the relevant background knowledge, would have considered the above to mean something different at the time this contract was entered.

I do not, for example, find persuasive an argument that because wages were not in the event of the claim paid, they were not payable. The appropriate position is to consider the counterfactual. Had it not been for the "damage", i.e. the interruption, M would have most likely employed its staff and in doing so would be obligated to have paid them. The consequence of the damage is that this did not happen, so there was a saving on these wages.

Because M was not required to fund 80% of its employees' usual wages due to the furlough payments it received, and because M chose not to top this amount up with the further 20%, M saved 100% of these wages against the usual expenditure it would have had.

I recognise that M did employee some staff, at some times over this period – so this only applies to staff that were furloughed and for the periods they were furloughed. But this is the basis of the settlement Covea has made.

M has also said that, had it not been for the furlough scheme it would have made its staff redundant so would not have had any expenses it would have needed to pay. However, ignoring for the moment any cost of making redundancies, had M done this it still would have saved 100% of its normal expenditure here. The appropriate counterfactual is not the situation that would have existed if there had been no furlough scheme, but rather the situation that would have existed had there been no pandemic. It is effectively the pandemic that is the "damage" in this case. And had it not been for this damage, M would most likely have had to pay 100% of its employee wages.

This means, a consequence of the damage was that this normal expense of the business was not payable, and so was saved.

M has said that it reduced its overall wage bill, so the full 20% of the normal wages it would pay, would never have been payable anyway. However, M would only have been able to claim furlough payments for staff that were still employed by the company, but were not working due to being furloughed. So, it is reasonable that this deduction is based on the level of furlough claimed.

Increased costs of working

I will start here by just clarifying the cover M has under the policy. M has referred to the "Additional Expenses" wording. This is not the cover it has though. M's policy schedule confirms that the cover provided is that under the "Gross Profit" term. This doesn't actually make a great deal of difference in the circumstances though, as the latter includes similar cover, being for loss due to an:

> "increase in cost of working being the additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in turnover which but for that expenditure would have taken place during the indemnity period in consequence of the damage, but not exceeding the sum produced by applying the rate of gross profit to the amount of the reduction thereby avoided"

My understanding is that M carried out works to its premises, including on a kitchen and on seating arrangements, etc. that allowed it to reopen under the restrictions that existed during the period of indemnity. Covea accepts that the cost of these ought to be covered in part, as this diminished the reduction in turnover. However, Covea has only agreed to settle 50% of these costs on the basis that M did and will continue to benefit from the measures taken beyond the indemnity period.

M has essentially argued that any betterment was an unavoidable consequence of the measures that were reasonably taken to mitigate its losses and that these were the least expensive route to do so. And so, M does not consider any deduction should be made.

One issue with this part of the claim and complaint is that M has not been able to supply anywhere near full invoices to set out the costs incurred and the works actually carried out. This is because the works were seemingly undertaken by the company that forms M's majority shareholder, and which itself is owned by one of M's directors. This means that, even if I were to be persuaded by M's arguments in principle, I would still find it difficult to

say that Covea ought reasonably to increase the settlement in this area. Covea may have been able to take the stance that as these costs have not been evidenced, it was unwilling to meet this part of the claim at all. I need to take into account Covea's willingness to work around this, when considering the claim overall.

The lack of evidence around this part of the claim also somewhat undermines M's argument that the level of expenditure it is claiming for was unavoidable. Whilst it has been accepted that M did need to carry out works in order to reopen at the time it did, and that these works enabled it to reduce the level of loss it experienced, Covea would not be a position to assess whether the amount claimed for the works was as low as it could have been. It would not have been able to determine whether the works, firstly, were all necessary, and secondly were carried out at the lowest possible price. I do note M's comments that a decision was taken to avoid the delay that might have resulted in seeking a third party to carry out the works and then assessing the cost-benefit of this. But this does mean it is now difficult to confirm that all of the costs claimed for were necessary and unavoidable.

Regardless of these points though, even if all of the costs were incurred by M, and were all necessary and unavoidable, I am not persuaded by M's argument that a deduction for the ongoing benefit of the expenditure should not be taken into account. M has and will continue to benefit from, at least some of, the works carried out beyond the period of indemnity. And it is fair that Covea takes this into account and makes a deduction.

Normally, where a policyholder acquires assets to enable it to carry on working, those assets are sold at the end of the indemnity period, or their notional value is deducted from the claim settlement. M has said the assets cannot be sold, as it disposed of the items they replaced. But this does not change the situation greatly. M is still benefitting from having these new assets, and it is fair for their notional value to be deducted.

M may no longer use the kitchen, but it is likely that it did so beyond the end of the indemnity period. And so would have gained a benefit that was not for the sole purpose of reducing the loss of income within the indemnity period. So, it is reasonable that Covea make a deduction for these aspects.

Setting this deduction at 50% does seem fairly arbitrary, but given the lack of supporting evidence from M, I do not consider this to be inappropriate. Requiring Covea to provide full details on issues relating to this, when M is unable to provide full details of its own position is not fair or reasonable. As I say, Covea may have been entitled to decline to meet any part of the substantial costs that have been claimed for, but have not actually been evidenced. That it has chosen to pay 50%, rather than 0%, means that I consider it has acted fairly and reasonably here.

Trend adjustment

Again, M has provided lengthy and detailed arguments around this point. I note the judgments M has referred to and the other arguments made. Fundamentally though, these come down to M considering the contract of insurance should be interpreted as one providing full indemnity for its losses. And so, this should take into account the estimated increase in its turnover that M considers would have occurred but for the COVID-19 pandemic.

However, whilst the principle of indemnity is important in insurance, in considering how Covea has settled this claim, it is necessary for me to consider the specific contract M has with Covea. And significantly to consider how a reasonable person with all the relevant background knowledge would most likely have interpreted this particular policy at the time it was entered in November 2019.

Some policies that cover business interruption will include a term allowing for the trend of the business to be taken into account. Others are silent on this, but also do not include any mechanics of how a claim should be calculated. In the case of these types of policy, it would be expected that an adjustment for trends be taken into account when making a claim settlement.

Where a policy sets out the mechanics of how a claim will be settled though, including provisions relating to how specific parts of this will be calculated, it is the application of these mechanics that will determine what the settlement should be.

M's policy with Covea defines a number of relevant terms, and then states how these defined terms will be used to calculate the insured loss and hence the claim settlement. M's policy states, in part, that Covea will pay:

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

A number of the terms in this wording are defined in the policy. Both parties are aware of these definitions and so I have not repeated them here.

Significantly though, the definition of "rate of gross profit" says that this is based on the rate that applied to the financial year prior to the damage. No provision is made for varying this to take into account a different rate of gross profit. Additionally, the insured loss is essentially the difference in the amount of turnover during the period of indemnity compared with the standard turnover; a term defined to mean the amount of turnover in the 12 months prior to the damage. Again, no provision is made for varying this to take into account an anticipated increase in turnover that would have occurred but for the damage.

I consider that a reasonable person, with all the relevant background knowledge, would have considered the wording of this policy clearly sets out how a claim settlement will be calculated and the various aspects that will be taken into account. Given the mechanism set out in the policy does not include making a variation for the trend of the business, I consider Covea acted fairly and reasonably by not making this adjustment when calculating the settlement of M's claim.

I have considered the rest of M's arguments over the settlement of its claim by Covea. However, looking at the situation holistically and considering the settlement offered by Covea in the round, I consider this offer to be fair and reasonable.

My final decision

My final decision is that I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask M to accept or reject my decision before 6 January 2024.

Sam Thomas
Ombudsman