DRN-5427181

## The complaint

A limited company, which I will refer to as T, complains about the handling and settlement of its business interruption insurance claim by HCC International Insurance Company Plc. The claim was made as a result of the COVID-19 pandemic.

## What happened

Both parties are aware of the circumstances leading to this complaint. So, the following is intended only as a summary.

T operates as a travel agency, and had a commercial insurance policy underwritten by HCC.

When taking out the policy, T completed a policy proposal form. It isn't clear if this was a form produced by T's broker, but the completed version was provided to HCC as part of the application process. The form asks for a number of details relating to T.

In terms of the business interruption cover, the form asks the question, "Is the standard £500,000 sum insured adequate?" There is a tick in the "yes" box next to this. The form then goes on to ask a number of questions relating to T's trading pattern. This includes asking about the relevant income streams and required T to complete the gross turnover figures for "this year" and "next year". T and HCC are aware of the figures given and that these differ slightly for the different years. As the policy was being taken out to largely cover the following financial year, I've referred only to the latter. The figures given for "next year" amount to a gross turnover of over £1.5m.

In March 2020, T was impacted by the COVID-19 pandemic and related government-imposed restrictions. It made a claim under the policy for business interruption.

HCC initially declined the claim. Following wider court action, this decision was overturned. It then took some time for HCC to assess the claim. Ultimately, it determined that it would only be meeting a proportion of T's claim on the basis that T's actual expected income was around £1.7m, but T had only insured £500,000 of this. HCC applied the average clause within the policy to set the proportion of the claim to be paid.

There are two terms referring to average, but as the parties are aware of these, I've only set out one. This says:

> "If the value of any property covered by this insurance at the time of any loss is greater than its sum insured the Insured will only be entitled to recover under this insurance such proportion of the loss as the sum insured bears to the total value of the said property"

In 2023, HCC said that the settlement ought to be based on a proportion of an overall amount of around £210,000. But, following T's complaint, increased this to around £307,000. Later in 2023, HCC paid an interim settlement of just over £60,000, which was based on the lower overall figure.

T was unhappy with some elements of the overall settlement figure, but was primarily concerned with the fact that the claim had been proportionately reduced in line with HCC assessment of underinsurance. T also raised concerns with the length of time taken and overall claim handling.

T brought its complaint to the Financial Ombudsman Service. Our Investigator recommended that the complaint should be upheld. He said that T had put HCC on notice of the full sums of money that it received, and had then taken out insurance that would cover more than the sum it would ever need to claim. So, with reference to the Insurance Act 2015 (the Act), he explained that he didn't think HCC had acted fairly and reasonably by proportionately reducing the claim.

The Investigator also thought that, ultimately, T's claim had been incorrectly declined in 2020. So, HCC should add interest to the settlement sum to take into account the fact T was without this money. He explained how this should be calculated, taking into account the circumstances. And the Investigator said that some other costs T had referred to should be added to the settlement.

T accepted this outcome, but HCC did not. It argued that the Act was not relevant in this case. HCC did not consider there had been a breach of the duty of fair presentation, as required by the Act. It said that T had chosen to cover only a proportion of its income, and therefore it was appropriate to apply the average clause. HCC also said that the Act was not intended to apply to average clauses.

In respect of the delay issues, HCC argued that it was not appropriate to add interest where there was a genuine dispute over the claim. And that, even if interest was appropriate, the level of interest and method of calculating this was not. Lastly, HCC referred to the fact that its decision to increase the overall claim value was made on a without prejudice basis to try to provide T with a gesture of goodwill in the face of the impact of the underinsurance on its settlement.

As our Investigator was unable to resolve the complaint, it 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.

I will firstly say that I have considered the full submissions from both parties. But I am not going to comment on every aspect referred to within these. Instead, I am going to focus on what I consider to be the key issues. This is not intended as a discourtesy, but rather reflects the informal nature of the Financial Ombudsman Service.

### The Act vs the Average clause

When taking out a commercial insurance contract, a customer needs to meet the duty of fair presentation (the Duty) set out in the Act. This, in essence, requires the customer to accurately disclose every circumstance that would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms.

I consider that the level of income a business generates – its turnover – would be such a circumstance in most situations. Certainly, I think that this would apply in T's case. Where a customer breaches the Duty, the Act sets out the relevant remedies that apply.

A customer might not breach the Duty where a disclosure is made which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances.

It is possible for an insurer and a customer to contract out of the Act. But where such a term would put the insured in a worse position than if the above duty applied, the term would have no effect unless the relevant requirements relating to “transparency”, as set out in the Act, are met.

HCC has said that, even where the Act applies, it is possible for an insurer to waive their rights under the Act. This is true. But it has limitations. It is not, for example, possible for an insurer to waive its right to pursue a remedy under the Act and instead rely on a contractual term that puts the customer in a worse position. An insurer may choose not to apply a potential remedy under the Act, and might either not take any action or might rely on a contractual term – but only where that contractual term does not put the customer in a worse position than if the Act were applied.

HCC has argued that the section of the Act relating to contracting out does not apply to average clauses. But I do not consider this to be correct from a legal perspective. Even if I am wrong on this point, I also do not consider it would be fair or reasonable for HCC to rely on the average clause if this were to put T in a worse position than if the remedies under the Act were applied.

HCC has said that it is not seeking to rely on a breach of the Duty. Its position is, seemingly, that T specifically chose to insure only a proportion of its income. So, there was no breach of the Duty. And it is therefore appropriate for HCC to rely on the average clause in the policy.

However, I think the appropriate starting point is to consider the Act and think about whether the Duty has been breached.

Loss of Income for a Travel Agent

Fundamentally, the issue in this case arises from the fact that, as a travel agent, the majority of the money T receives from customers is not money T retains. For example, when selling an airline ticket, most of the money handed over to T is then paid to the airline.

HCC has said that this is not overly different to how other many businesses operate. I agree to an extent, but not entirely.

Using a random analogy, a greengrocer who sells apples needs to pass on the majority of the money received to the farmer that grows those apples. There are potentially differences in the timing of such payments – the farmer likely would be paid before the apples are in the shop, the airline wouldn’t need to be paid to allow the travel agent to offer the flights to a customer. But essentially, most businesses offering a product for sale will have a significant difference between their income and their profit. Such businesses are probably best suited by having a policy that is based on a loss of profit.

This can be contrasted with a service based business, such as a lawyer or accountant. These businesses to not provide a tangible product. And, other than fixed costs (for example, rent), their income will more closely match their profit. So, these businesses can suitably be covered by policies based on a loss of income.

T operates both as a seller of products and also as provider of services, in that an element of its income is also derived from combining various products into packages and providing booking services, etc. And there is a split in the type of revenue T receives, which most likely relates to the legal requirements and liabilities relating to packaged holidays. This means, there is something of a question over whether taking out a policy that is based on loss of income is appropriate.

I should say that my brief explanation above about the type of policy that is suitable should not be interpreted as a global finding, or even one specifically about T. There are service based businesses that would benefit from having a loss of profit policy, and product based businesses whose needs would be met by loss of income cover. I am merely providing some loose commentary to assist, mainly, T to understand the circumstances better and to provide some context.

Additionally, the current complaint is about HCC's treatment of the claim under the policy that was taken out. It may be that T was not properly advised by its insurance broker. But that is not the issue that I am determining here. As far as HCC's requirements go, it is entitled to consider T and its broker as one in the same.

Ultimately, the policy that T took out is based, as far as is relevant, on providing cover for loss of income. The policy defines income as:

> "Money paid or payable to the Insured for services provided in the course of the Business at the Premises"

I do consider that this is all of the money that is payable to T by its customers. Arguments have been made that this should only be considered as the "retained income". But I do not consider this is a fair and reasonable interpretation of the policy, nor one which a reasonable person with all of the relevant background knowledge would have.

The policy then goes on to set out how losses will be calculated though. The parties are aware of the exact wording. But this is essentially the shortfall between income expected and received, less any amount saved that otherwise would've been payable out of that income.

So, the amount insured by the policy is the loss of income, less any savings.

In a situation where the amount of income is effectively largely made up of a variable cost that will not be incurred unless that income is generated, the savings that will be realised will be a significant proportion of the overall income. In T's case, using the example of the airline ticket, the pandemic meant that T did not have customers booking airline tickets, so it lost this income. But it also saved on the amount that it would've spent buying the ticket for the customer. (I use this merely as a hypothetical example, as I haven't been provided with details of the mechanisms of such purchases, etc.)

Where T, or any travel agent, suffers an interruption to its business, the loss and savings would work in a similar manner. It would not incur the majority of costs if it was not generating the income. So, for a travel agent, the loss that it needs to insure will always be limited by the proportionately significant level of savings it will achieve. The retained income will always be significantly less than the total income received.

As a result, in saying the standard £500,000 cover would be adequate, T was arguably giving a correct answer. Based on my understanding of its income and expenditure, T would never be able to claim more than this as part of a business interruption claim under the policy.

<u>Did T breach the Duty?</u>

Having said that, it is likely that T/the broker's ought to have set the sum insured in line with the level of income. As I have set out above, a claimant would only be able to claim for, what is essentially, the expected amount of retained profit that was lost (the loss of income less the savings made). However, when providing the cover, HCC would most likely have been assessing this on the potential that this represented the overall risk posed by T. A prudent insurer would consider the overall income of a business as being as material circumstance.

T's decision to answer the question on whether the £500,000 standard cover was adequate was based on its apparent understanding that the policy was based on its retained profit. This appears to be the broker's understanding, as this is effectively the argument that has been put forward, with the broker saying this is the approach across this sector of the industry, and that the company that drafted the policy wording has also indicated this is how it ought to be interpreted. From T's point of view, the question it was answering was "what is the most you could claim under the policy?", rather than "how much of the potential risk do you want covered?".

Regardless, even if T ought to have – in order to have its full losses covered – answered this question "no" and changed the sum insured to the full level of income it received, it seems that answering this question "yes", was an error by T/the broker, rather than a conscious decision for T to "self-insure" part of its own risk.

In making this error, T would potentially be in breach of the Duty. As the policy it was taking out was based on its entire income, potentially it ought to have declared its risk to HCC as being £1.7m. It did not so, so would be potentially in breach of the Duty.

However, the Act also says that where a customer provides information to an insurer that effectively puts it on notice that it needs to make further enquiries about the relevant circumstances, there is no breach of the Duty in relation to those circumstances.

In this case, T said £500,000 was adequate to cover its income, whilst also setting out that its turnover was in excess of £1.5m. I consider that this ought reasonably to have led HCC to make further enquiries to determine why this discrepancy existed.

I do appreciate HCC's point of view that it could consider that T was making a conscious decision to only insure part of this overall turnover. And I also appreciate that T was being represented by a broker who HCC could reasonably rely on to appropriately advise T. However, I don't consider that the information provided could reasonably be relied upon by HCC to demonstrate that T was consciously deciding to self-insure the majority of its potential losses. Certainly, I don't think this was a position HCC ought to have reached without further enquiries.

It follows that, taking things as a whole, I do not consider T was in breach of the Duty.

<u>Can HCC rely on the Average clause?</u>

Given I do not consider T was ultimately in breach of the Duty, does this mean that HCC can rely on the average clause to limit the claim settlement?

As referred to above, there is an argument that, with reference to the average clause, the value of the property covered by the insurance was the total income less the savings that would be realised on that income. Due to the products and services being provided by T, the full sum of the income expected to be received from these would never have been payable as part of an insurance claim.

As a result, when answering the question "is the standard £500,000 sum insured adequate?", unless HCC could conceivably be required to pay more than this, there is neither a breach of the Duty nor was the property covered by the insurance greater than this.

For reasons below, I do not consider it is necessary to make a finding on this point.

This is because I consider that it would only be fair and reasonable to rely on the average clause in circumstances similar to this case where the policyholder was consciously only insuring a part of the potential risk. I consider that the fair and reasonable approach in these circumstances is that either the customer was aware of the fact they were self-insuring and so the average clause applies, or that they made an error and so were potentially in breach of the Duty.

In T's case, I consider that T potentially made an error when answering the question over the level of indemnity required. So, the Duty would then apply. The only reason it does not is that further information was given that means HCC ought to have made further enquiries.

Reaching a different conclusion here would mean that an insurer was able to circumvent the requirement of the Act to make further enquiries, so as to rely on more onerous terms set out in an average clause. I don't consider this would be fair or reasonable.

The requirement for the customer to be consciously only insuring part of the potential risk is reflected in the requirement within the Act for terms that contract out of the Act to meet the transparency requirements set out within the Act. I do not consider HCC met these requirements.

It follows that, in the circumstances of this particular case, it would not be fair or reasonable for HCC to rely on the average clause.

Delay

HCC has said that it should not be responsible for paying interest from the point T's claim was declined in 2020, as effectively there were reasonable grounds for HCC to dispute liability. Whilst I fully appreciate the events from 2020 onwards in terms of the various court actions that led to liability being accepted, ultimately the decision HCC made in 2020 was incorrect. And as a result of this incorrect decision, T was left without funds that it otherwise would have had. HCC did not have to wait for the court action to reach a different conclusion. I appreciate why it did wait. But this had an impact on T that I consider it is fair and reasonable that HCC redress.

HCC has also argued that it is inappropriate to base this interest on a situation where interim, monthly payments are made whilst the claim circumstances are ongoing. However, I fundamentally disagree with this. Where there is a situation of ongoing loss – such as business interruption due to property fire or, as in this case, the pandemic – it is fair and reasonable that an insurer be expected to make regular payments to the insured. This is also a position that is taken across the insurance industry, so is in line with good industry practice. I appreciate that the full loss may not have crystalised and so cannot be calculated. But I do not consider this ought to prevent an insurer making payments on losses that have incurred to date – taking into account a suitable period to calculate these.

HCC also disagree with the level of interest recommended by our Investigator. But this is in line with the default position currently taken by the Financial Ombudsman Service. This interest rate can be varied depending on the circumstances, and I note that in this particular case T took out a Business Interruption Loan which carried a lower rate of interest. It is appropriate that, in respect of the amount of this loan, HCC only be required to meet the level of interest T was actually required to pay. But I have not been provided with persuasive evidence that anything else should vary the default interest rate.

The sum that ought to be paid

I do note that HCC increased the settlement offer in 2024, saying that this was on a without prejudice basis. A number of changes were made. This included the exact percentage used to calculate the rate of gross profit applied to the losses. I should point out that use of a rate of gross profit isn't strictly the way the policy operates. However, generally speaking, I do not consider this would have a negative impact on T, so make no finding on this particular point. In terms of the specific rate used, the issue here is whether the 11.04% rate used in 2023, or the 11.35% from 2024 is appropriate. Whilst I note HCC's reasoning and apparent issues with relying solely on the annual accounts over the monthly management accounts, it is recognised that there are general difficulties with precisely calculating a business interruption loss. Given the disputed accounts give a higher figure of 11.66%, I consider that taking the average of these (11.35%) is fair and reasonable. And I consider HCC should stick to this figure.

The second notable change in 2024 related to the amount of customer money held by T, and how much of this needed to be refunded vs paid to suppliers for cancelled trips. I do note that there is apparently a lack of documented evidence around the precise amounts that would be retained/had been paid to suppliers. So, I appreciate why HCC came to the initial 2023 decision on this point. But, whilst noting it was doing so on a without prejudice basis, HCC has also set out persuasive reasoning why part of this element ought to be included within the settlement calculation. And I am persuaded that it is fair and reasonable for this element to be included/retained within the settlement calculation.

Our Investigator recommended that HCC pay the accountant's fees T incurred in dealing with the claim. HCC has agreed to cover £3,500 of the accountancy fees, which was the proportion apparently supported by invoices. This appears fair and reasonable, albeit should T be able to evidence that additional sums were paid I would expect HCC to consider these.

And our Investigator recommended HCC pay the cost of T retaining records on an IT system from a period 12 months after the start of the claim process. HCC has pointed out that this cost may have been incurred anyway – due to the need to retain records for tax and accounting purposes. Whereas T has said that these purposes would not have required the records to be retained on this paid-for system. Overall, I am persuaded that T most likely would not have needed to pay to retain this system had its claim not been initially declined and then been dealt with in the manner I consider it ought to have been. So, I think this is a consequential loss T has incurred due to HCC's actions, and it follows that HCC should cover this cost from April 2021 to the date of this decision. This is subject to T providing HCC with evidence of these costs.

Given my findings above, neither of these elements ought to be subject to any reduction for underinsurance.

**Putting things right**

In order to put things right, HCC should:

- Settle the claim on the basis that T was not underinsured – so HCC should not apply either the average clause or the relevant remedies under the Act. The settlement should otherwise be based on the approach HCC took in 2024,

- Include in this settlement the accountancy fees and cost of the back-office system incurred by T, subject to T providing HCC with evidence of these, and

- Add interest to this settlement, calculated in the manner set out below.

The interest payable on the settlement should be based on T having been deprived of monthly interim payments that should have been made during the course of the claim.

The first of these payments should have been paid two months after T made its claim in March 2020 – to allow for a period for loss to crystalise and for HCC to assess these losses. And should have covered T's indemnified losses for the period 23 March 2020 to 22 April 2020 inclusive. Subsequent monthly payments should have been based on losses for the periods; 23 April 2020 to 22 May 2020, 23 May 2020 to 22 June 2020, etc. These payments should have been made in each of the following months.

HCC should pay T interest on the amount of each of these interim payments, for the period from the date of each of these interim payments should have been made to the date of settlement, taking into account the partial settlement already made.

This interest should be paid at a rate of 8% simple per annum.

However, HCC is entitled to deduct from this interest calculation any interest that would be payable on the sum of T's bounce back loan, for the period T had the benefit of this loan. HCC should instead pay T the cost of its borrowing under the bounce back loan, including any fees and interest that has accrued at the point of settlement.

**My final decision**

My final decision is that I uphold this complaint. HCC International Insurance Company Plc should put things right as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask T to accept or reject my decision before 18 July 2025.

Sam Thomas
**Ombudsman**