

## **The complaint**

The partners of a partnership I will refer to as M, complain about the calculation by Society of Lloyd's of their business interruption insurance claim made as a result of the COVID-19 pandemic.

Specifically, they complain about the calculation of underinsurance and how this has been applied to the claim.

## **What happened**

The following is intended only as a brief summary of the main events. Additionally, references to Lloyds includes Society of Lloyd's, the relevant underwriters, and their agents. For the sake of simplicity, I have largely just referred to M and Lloyds.

M is a partnership and operates as a holiday accommodation business and held a commercial insurance policy underwritten by Lloyds. The policy provided a number of areas of cover, including business interruption. Following the government-imposed restrictions, introduced in March 2020 to limit the spread of COVID-19, M claimed for its losses.

Ultimately, Lloyds agreed to meet the claim and offered a sum in settlement. However, M was unhappy with the offer. This complaint is limited to considering whether Lloyds fairly and reasonably applied a rate of underinsurance to the claim settlement. Lloyds said that the policy M had taken out only provided £30,000 of cover, but this should have been over £77,000. Lloyds said that it would have charged more for the policy had it covered this higher amount, and so M had only paid, just under, 39% of the premium it should have. It rounded this up, and applied a 39% rate of underinsurance to M's claim.

M was unhappy about this. It has also raised complaints about the sale of the policy and also in relation to certain other deductions that have been made to the settlement. However, these have been considered separately and this decision is limited to considering the rate of underinsurance.

M was largely unhappy because Lloyds' calculation of the appropriate sum to be insured does not make any deductions for variable costs. Whilst its turnover may have been around £77,000 the policy insured against loss of trading profit. And M considers deductions should be made for a number of costs, including subcontractor costs, light and heat, repairs and maintenance and cleaning. M says that these costs are directly related to the turnover achieved.

M brought its complaint to the Financial Ombudsman Service, but our Investigator did not recommend it be upheld. He thought, as M had only declared its trading profit as £30,000, it had breached the duty of fair presentation of risk. So, Lloyds was entitled to apply the rate of underinsurance. And this had been done in line with the Insurance Act 2015 ("the Act").

M remained unsatisfied and its complaint was passed to me for a decision. M's complaint seems to be largely focussed on whether the costs above should be deducted from the turnover to reach the figure of trading profit that needed to be declared.

I contacted M to set out my initial thoughts. I explained that the terms accountants use, and the terms used in insurance, do not always have the same meaning. And that where a policy uses a specific definition, it is that definition which is relevant. In this case, M's policy defined trading profit as:

"The takings less the cost of goods or materials."

And that I did not think the costs listed above were likely to fall into the category of goods or materials in this situation. I also said that I thought these costs were, at most, semi-variable costs and so would not be deducted from the takings to establish the trading profit figure based on what had been set out in the schedule and policy.

M responded in some detail. It explained that only a small proportion of its energy bill was non-variable – with the majority being used by the 'accommodation units' directly. However, M also set out a number of costs that it had to meet irrespective of whether it had customers. And M said that it could not have known what its accounts would show when the policy was taken out. M also raised a number of queries over whether the policy was suitable for a business of its nature.

### **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.

In order for Lloyds to fairly and reasonably apply a rate of underinsurance to the claim, it needs to demonstrate that M breached the duty of fair presentation. The requirement for M to meet this duty is set out in the Act. In order to fulfil a fair presentation of risk, the Act says a commercial policyholder must disclose everything they know, or ought to know, that would influence the judgment of an insurer in deciding whether to insure the risk and on what terms.

I am aware that M informed its broker that its turnover was around £75,000. However, the insurance taken out was based Lloyds providing cover for "trading profit" as defined in the policy. As I have said, this definition is that which is relevant here, rather than any other definition or interpretation. And Lloyds were led to understand that M's potential loss of trading profit would not exceed £30,000.

So, the question effectively is, did M fairly present the risk by saying the takings less the cost of goods and materials was £30,000?

The term "takings" is also defined in the policy, but is largely equivalent to what would be understood as the turnover for M's business. And using a figure of £75,000 for the takings appears potentially reasonable. Lloyds have calculated the actual sum generated to be slightly over this, but not materially different.

This issue is whether this entire sum was trading profit as defined by the policy.

As I have previously set out to M, many policies insuring on the basis of loss of profit reach this figure by subtracting variable costs from the income generated. These are the costs proportionately variable with the cost of providing the goods or services in question. In the event of an interruption to business, these costs decrease – so should not be included in an insurance settlement; they are not costs the insured business has incurred, so they should not be paid for these costs by an insurer. By not insuring these costs, a lower total insured figure is needed, which lowers the risk to the insurer and thereby the price of the policy.

I've also explained that it is possible to insure semi-variable costs. But to do so a policyholder would need to be quite explicit about what was being insured and the relevant proportions of such a cost.

M's policy does not specifically state that it is providing insurance on this basis. The uninsured element of the takings/turnover is the "cost of goods or materials".

M has raised concern that such a policy is not appropriate for a business of its nature, where there are only limited goods or materials that are provided in relation to the accommodation bookings it provides. However, this current complaint concerns how the claim was settled rather than whether the sale was appropriate.

Given there would only be very limited, if any, goods and materials provided in relation to achieving M's takings, applying the policy term strictly means all of the takings would be trading profit.

I have considered whether this is fair and reasonable. But even if the more general insurance basis of calculating the trading profit by deducting variable costs were to be applied to the circumstances, I don't think this would lead to a different outcome.

The costs M has referred to above are at best semi-variable and without these being specifically excluded from the insured sum, I consider that it would not be fair or reasonable to deduct them from the takings to reach the trading profit figure.

M's response to my initial thoughts supports that these costs are not proportionately variable to the level of business provided, i.e. to the number of bookings. It has said that the majority of the utility costs are for the distribution of energy to the individual bookings, but that a proportion is used for the site generally. And that, irrespective of bookings, there are costs with fire safety and site maintenance, etc.

I do appreciate that the actual profit M will receive from its business is not the full turnover. But this is not what the insured amount is. The insured amount is the "takings less the cost of goods or materials" or, at best, the turnover less totally variable costs. This is the amount M should have declared when the insurance was taken out.

Based on the information provided, I am persuaded that Lloyds has fairly and reasonably calculated that this amount should have been just over £77,000. As M insured only £30,000, and did not for example advise Lloyds that it was self-insuring the remainder, I am satisfied that M breached the duty of fair presentation that applied to it.

The Act sets out how a breach of this duty should be treated. Essentially, where the insurer would have entered the contract but charged a higher premium, it may reduce proportionately the amount to be paid on a claim. Lloyds has said that had M accurately presented the insured risk as being just over £77,000 it would have charged more for the premium. And so, M had only paid 38.65% of what it should have. Rounding this up to 39% is not to M's detriment. And applying this figure to the claim settlement calculation is in line with the Act and in all the circumstances fair and reasonable.

I appreciate this outcome will come as a disappointment to M and its partners. But hopefully I have been able to explain why I have come to this decision.

### **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 27 October 2023.

Sam Thomas  
**Ombudsman**