

The complaint

Mr F is unhappy with what DAS Legal Expenses Insurance Company Limited did after he made a claim on his legal expenses insurance policy

What happened

Mr F had a dispute with his former employer and made a claim on his legal expenses policy for assistance. DAS accepted the claim and agreed Mr F could use his own solicitor to pursue it. Subsequently it agreed terms of appointment with a different firm. In both cases DAS agreed a rate of £100 an hour with Mr F being responsible for costs in excess of that.

In May 2021 Mr F's solicitors contacted DAS and said they were discussing settlement with his former employer. And to structure this in a tax efficient way they were intending to apportion an element of the award as legal fees. They asked whether this would have any implications for Mr F's right to recover sums under his policy. DAS emailed the solicitors on 21 May and said *"I am writing to advise I have noted the agreement however we are unable to comment further"*.

The following month the solicitors advised the claim had settled on the basis of that agreement. They sought to recover the costs incurred which they thought were covered by the policy. DAS said the settlement agreement included an amount of £164,000 for legal fees. As that exceeded its liability under the policy (and there had been no agreement this should be used to cover uninsured costs) it didn't agree to make any payment.

Our investigator said when Mr F's solicitors got in touch with DAS it should have made clear it didn't agree to the proposed settlement. And having reviewed the agreement and associated correspondence she was satisfied the intention was for Mr F to receive the full amount set out in that agreement as compensation. There was no mention of it covering legal costs in the proposals from his former employer. So she thought it was fair DAS should cover his legal costs up to the indemnity limit set out in his policy.

DAS didn't agree to do that. It said it was the agreement itself which should be considered when deciding what was covered. And that specifically apportioned an element of the settlement to legal costs.

That might have been done for reasons of tax efficiency but if it was intended the full amount of compensation should have been awarded to Mr F that should have been made clear in the agreement. It accepted it could have made its position clearer in May 2021 but it didn't think it was reasonable of Mr F's solicitors to have assumed from its response that it agreed the proposed settlement.

Mr F's solicitors also provided further comments. In summary they said:

- There had been no discussion of legal fees being covered in their negotiations with the other side and the final offer made of £525,000 in full and final settlement didn't include these either. The wording of the settlement agreement didn't tell the whole story and looked at as a whole it was clear agreement was for the payment of the full amount in compensation.

- The employer did agree to make payment in a tax efficient way which meant part of the settlement was apportioned to legal fees meaning tax wasn't payable on that amount. It believed those arrangements were entirely in line with the relevant legislation and met its provisions. But it didn't accept this changed the underlying nature of the payment.
- They had explained the arrangement to DAS prior to entering into the agreement and it hadn't objected to this. If it was unhappy with the proposals it should have made that clear.
- They thought that in addition to payment of costs DAS should also pay interest on those amounts and compensate Mr F for the costs he'd incurred in pursuing a complaint about these matters (for which it estimated costs of around £5,000) plus compensation for distress and inconvenience.

I issued a provisional decision on the complaint in October. I said:

The relevant rules and industry guidelines say DAS has a responsibility to handle claims promptly and fairly. It shouldn't reject a claim unreasonably

I've looked first at the terms and conditions of Mr F's policy. These say "you must tell us if anyone offers to settle a claim". The policy also requires the insured to "take every step to recover costs and expenses that we have to pay and must pay to us all such costs and expenses that are recovered". And it says "if you decide not to use the services of a preferred law firm you will be responsible for any costs that fall outside our standard terms of appointment and these will not be paid by us".

In this case Mr F did achieve a settlement of his claim. I think the first issue is whether DAS are right to have concluded that settlement did include cover for his legal costs. And I recognise that, as his representatives have said, this doesn't appear to have formed part of the discussions prior to the settlement being agreed. The offer made through his employer's solicitors was for a total of £525,000 and didn't make any reference to that including costs.

However, I think it's difficult to ignore the clear wording of the agreement itself. This set out that the former employer will make a gross compensation payment of £361,000 (the Compensation Payment).

The following paragraph then say it will also pay "the individual's legal fees incurred in obtaining advice...in respect of the termination of the Individual's employment". It describes that as the "Legal Fees Payment". And it explains how those payments are to be provided to the two firms involved with the case.

Mr F's representatives argue settlement was simply agreed in this way to make it more tax efficient. And they've referenced s413A of the Income Tax (Earnings and Pensions) Act. I understand that provides tax isn't payable on certain legal costs incurred exclusively in connection with the termination of the employee's employment. Apportioning some of the amounts payable to Mr F as legal costs therefore reduces the tax he needs to pay.

But I don't think this is simply a "paper exercise" as they've suggested. HMRC's Employment Income manual (available online) provides guidance on this section. It sets out a number of conditions that need to be met for it to apply which include that "the payment is applied to discharge the bill for solicitor's costs that the employee has incurred only in connection with the termination of the employment". So for that payment to be free of tax it needs to discharge the bill for solicitor's costs (and as a result would be paid direct to the solicitor and not to Mr F). And that's the basis on which both parties entered into the agreement.

Taking into account the wording of the agreement, the relevant legislation and the guidance issued by HMRC I don't think DAS has acted unreasonably in concluding that the payment in this case wasn't simply compensation but contained an element that covered solicitor's costs Mr F had incurred. I don't think it's reasonable to say the same payment can constitute legal fees for tax purposes but represent compensation for the purposes of an insurance claim.

So I've gone on to consider what happened when Mr F's representatives got in touch with DAS to let it know about the proposed agreement. Prior to it being agreed they contacted DAS on 13 May 2021 and provided a copy of the agreement the following day. DAS responded on 21 May and said "I have noted the agreement however we are unable to comment further". I think (and I understand DAS accept) it should have made its position clearer. In my view its response should have included that as the agreement said Mr F had recovered legal costs it would take those into account when calculating what liability it had under the terms of his policy.

I've thought about whether Mr F has lost out because DAS didn't do that. In particular whether he'd have entered into the agreement on different terms if its position had been made clear. I don't think that's likely. His representatives say the agreement was completed on 17 May 2021. That's prior to DAS providing its response on 21 May. So even if DAS had made its position clearer it wouldn't have made a difference because the agreement had been entered into prior to Mr F's representatives receiving that response.

And for the reasons I've explained I think DAS was entitled to conclude the agreement did include an amount for legal costs incurred by Mr F. I think it was reasonable of it to take those into account when considering what remaining liability it had for those costs. And DAS says costs at the agreed £100 an hour from Mr F's current and previous solicitors amounted to around £135,500. As the amount recovered (£164,000) exceeded that it didn't think any amounts under the policy were due to Mr F.

I don't think that's a fair way of approaching this issue. The policy definition of 'costs and expenses' includes "all reasonable and necessary costs chargeable by the appointed representative and agreed by us in accordance with our Standard Terms of Appointment". So I accept DAS would only be responsible for the reasonable and necessary costs incurred by Mr F at the agreed rate of £100 an hour.

And as I've already outlined the policy also says "you must...take every step to recover costs and expenses that we have to pay and must pay to us all such costs and expenses that are recovered". I don't think there's any suggestion there's been any failing on the part of Mr F or his representative to recover costs they should have done. In fact as costs aren't normally recoverable in Employment Tribunal cases they've arguably obtained more than would normally be expected.

The difficulty in this case is the costs and expenses Mr F incurred were much greater than the amount DAS agreed to pay because the hourly rates charged by his solicitor were significantly more than £100 an hour. I understand Mr F was therefore responsible for topping this up.

And while the settlement agreement awarded £164,000 for legal costs it didn't apportion these between those for which Mr F was responsible and those which were the responsibility of DAS. So it isn't clear what amounts awarded under that agreement would be costs and expenses that DAS has to pay and so, in line with the terms of the policy, could reasonably be used to offset its liability.

I've considered the terms of appointment Mr F's representatives signed (the 'Working Together' document) but I don't think that assists either. It says "For Claims in the

Employment Tribunal we will be liable for your Costs at the rate of £100 plus VAT per hour, unless you recover any such sums from the opponent". Mr F has recovered sums from his employer but the question remains as to how those should be apportioned between his costs and those for which DAS is responsible.

I've thought about what the right way of approaching this issue would be. In the circumstances of this case, I think it would be fair to apportion costs recovered on the basis of the respective liabilities of the parties for those costs. And I think the agreed hourly rates provide a reasonable starting point in relation to this. There's no dispute that DAS's contribution to those costs was fixed at £100 an hour. So I've looked at the hourly rates charged by the solicitors who acted for Mr F.

There's significant variation in those rates depending on which firm and fee earner was carrying out the work. I don't think any calculation here can be an exact science. But looking at the overall figures I think it's fair to apply an overall hourly rate of £500 which represents a relatively conservative estimate of the amounts charged. Mr F's contribution to that would therefore be £400 an hour.

On that basis the costs awarded in the settlement agreement would be allocated on an 80:20 split in favour of Mr F. That means £32,800 would go against those costs and expenses incurred by DAS. As a result I don't think DAS's liability has been extinguished by the award for legal costs made in the settlement agreement.

I appreciate the policy also says "if you settle a claim or withdraw it without our agreement...we can withdraw cover and we will be entitled to reclaim from you any costs and expenses paid by us". I recognise DAS didn't provide agreement to the settlement in this case.

But the wording of that term refers to "you" which the policy defines as the insured (so Mr F). And I understand this claim was settled based on advice from his appointed representatives. In any case DAS was aware of the proposed settlement and didn't take appropriate action in relation to it. And I've already explained what I think it should have done here. So I don't think it would be fair of DAS to use this term as grounds to turn down the claim.

Putting things right

DAS will need to reconsider the costs claimed by Mr F in line with the policy terms and will be entitled to take into account the requirement to only pay reasonable and necessary costs. Once DAS has calculated its outstanding liability it will be entitled to subtract the £32,800 apportionment from any amounts then owed to Mr F. And it can then apply any remaining terms and conditions of the policy including of course the indemnity limit. I also accept that Mr F will have been caused some distress and inconvenience as a result of his claim being incorrectly turned down and I think DAS should pay him £200 in recognition of that.

I appreciate Mr F's representatives think interest should be paid on any amounts due to him. However, under our rules I'm only able to do so where I'm making a 'money award (for example where we're directing a business to make a payment for financial loss). In this case my direction is for DAS to reconsider the claim so that isn't something I'm able to do.

I've also considered whether DAS should reimburse Mr W for the legal costs he incurred as his representatives suggest. Our rules do allow us to direct a business to cover some or all of the costs reasonably incurred by the complainant in respect of a complaint (and include interest on that amount).

But the rules also make clear that awards of costs are unlikely to be common because in

most cases complainants should not need professional advisers to bring their complaint to our service. In this case I understand why Mr F may have wanted to seek professional assistance in bringing his complaint but I don't think that was something he needed to do. So I don't think this is an appropriate case in which to make an award of costs against DAS.

Reponses to my provisional decision

DAS said it had concerns as to how the figures for its contribution had been calculated. It asked for more time to discuss this with cost assessors but didn't then provide any further comments by the extended deadline.

Mr F's representatives did provide detailed comments. In summary they said:

- It was common practice in employment claims for termination payments to be reduced and allocated against legal costs and this simply constituted a relabelling for tax purposes. It didn't mean those legal costs had actually been recovered. And all monies paid under the agreement were paid to it in the first instance.
- It thought accepting costs had been recovered allowed DAS to avoid its responsibilities under the policy and said if the position was reversed (so Mr F had agreed an amount for legal costs in advance but the settlement agreement allocated the full sum to compensation) DAS wouldn't have paid a claim for legal costs in that situation either.
- It said DAS had the opportunity over four working days to clarify its position but failed to do so. And that followed on from previous examples where DAS had been unresponsive to settlement requests. It said if DAS had made its position clear in this case Mr F might have considered other tax mitigation strategies.
- It said the settlement agreement did apportion costs with an amount being allocated to uninsured fees incurred by Mr F's former solicitors which were separate to those claimed under the policy. It thought these should be disregarded from any calculation.
- Costs claimed under the policy in March 2021 by the former solicitors weren't included in the costs award made under the agreement either. So they shouldn't be taken into account when considering what costs Mr F had recovered under that agreement.
- It also disagreed that an 80:20 split was appropriate when allocating the legal costs the settlement agreement had awarded. It said this didn't take into account that not all of the legal costs it had incurred were claimable under the policy. It thought this should be reflected in the calculation and set out how it thought this should be done.
- It didn't the proposed compensation of £200 was enough and drew attention to poor service provided by DAS throughout the history of the claim. And it thought it was relevant that this was an expensive policy aimed at high net worth individuals.
- It said Mr F needed to seek professional help in order to 'level the playing field' when engaging with DAS and it wasn't reasonable to expect him to pursue a claim of this nature without that. It thought he should be awarded the costs he'd incurred in doing so and said not doing so would provide no incentive for DAS to take complaints seriously.

- It didn't understand why Mr F shouldn't be awarded interest on any amounts paid under the policy given the delay in handing his claim. It said it was unsupportable to draw a distinction between a 'money award' and a direction to reconsider the claim.

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 appreciate that Mr F's representatives consider the wording of the agreement simply represented a relabelling for tax purposes and didn't mean legal costs were actually recovered. And I've taken into account that the offer made through his employer's solicitors was for a total of £525,000 and didn't make any reference to that including costs.

But, as I explained in my provisional decision, I've also taken into account the relevant legislation, guidance issued by HMRC and the agreement itself. I think it's worth restating the plain wording of that agreement which says the "*Legal Fees Payment*" covers *the individual's legal fees incurred in obtaining advice...in respect of the termination of the Individual's employment*". And while I note the comments Mr F's representatives have made about the view DAS might take on an alternative situation it's the claim Mr F actually made I'm considering here.

And the question for me is whether it was unreasonable of DAS to conclude the payment in this case wasn't simply compensation but contained an element that covered solicitor's costs Mr F had incurred. For the reasons I've explained I don't think it was. I continue to feel it's difficult to sustain an argument that the same payment can constitute legal fees for tax purposes but represent compensation for the purposes of an insurance claim.

I've therefore given further consideration to the points Mr F's representatives have made about DAS's actions when it got in touch about the proposed settlement in May 2021. I appreciate Mr F was under pressure to make a decision about this. I also accept DAS didn't give a clear answer when it responded on 21 May. But I don't think Mr F would have done anything different if DAS had done so.

Even if DAS had acted as it should, it would still have needed time to consider its position in relation to the agreement. And Mr F entered into the agreement on 17 May which in my view is before he could reasonably have expected a response from DAS. I understand why he did that given the pressures his representatives have referenced. But that means even if DAS had provided a clearer response it wouldn't have made a difference because Mr F would already have entered into the agreement prior to that response being received.

Turning to the costs awarded under the settlement agreement I appreciate it does make reference to costs incurred by both Mr F's current and former solicitors. And Mr F's representatives have said in relation to the costs incurred by his former solicitors it only covered uninsured costs. It therefore argues those costs should be disregarded in any apportionment between Mr F and DAS (and any sums due to DAS shouldn't be allocated against the insured costs claimed by the former solicitors).

It argued the remaining policy indemnity should then be split initially on the 80:20 basis I suggested but then with a further adjustment on a two third to one third basis in favour of DAS to reflect the split between insured and non-insured legal work it had carried out.

I don't think that's the right way of approaching this issue. First, I'm not persuaded applying an 80:20 split to any remaining policy indemnity limit is appropriate. What I said in my provisional decision was this should be applied to the costs awarded in the settlement

agreement. And that 80:20 split was based on an assessment of the hourly rates charged by the firms (and fee earners) involved.

Mr F's representatives have suggested a further split should then take place to reflect the difference between insured and uninsured work carried out and say this should be done on a two third to one third split in favour of DAS. But I don't see that's appropriate. The apportionment I've suggested already recognises there's a split between uninsured and insured costs and uses the agreed hourly rates for those different elements as a way of establishing the respective liabilities of the parties for those costs.

I accept, as I've said, that this isn't an exact science but I don't think the approach proposed by Mr F's representatives would result in a fairer outcome. His representatives have acknowledged themselves that their split represents a "*rough and ready*" figure. And they've applied this split to the amount remaining under the policy indemnity which I don't think is the right approach. I think the apportionment I've proposed remains appropriate.

Mr F's representatives also say costs awarded under the settlement agreement as they relate to Mr F's former solicitors only relate to uninsured costs. So these should be disregarded from any calculation. I agree in principle if it was clear an element of costs awarded under the settlement agreement solely related to uninsured costs they should be disregarded when deciding to what extent DAS's outstanding liability had been reduced by the costs awarded.

But his representatives haven't provided any further evidence in support of their position. And the agreement itself doesn't say the allocation of any award to his former solicitors would only cover uninsured costs. It says "*the Employer will also pay the individual's legal fees in obtaining advice from [previous and current legal representative]*".

I appreciate Mr F's former solicitors submitted a claim to DAS for costs they believed were covered under his policy but that doesn't mean those costs couldn't also be ones that were in part recovered under the settlement agreement. I also find it contradictory for Mr F's representatives to argue legal costs weren't recovered under the settlement agreement at the same time as saying it specifically covered only uninsured costs from his former solicitor. So I'm not persuaded to change my position on this issue.

Turning to the compensation I suggested I note the points made about the service provided during the history of the claim. But it's the impact of DAS's decision to turn down his claim that I'm considering in this decision. Mr F hasn't provided any more information about how that impacted him so I continue to feel the £200 I previously recommended is appropriate.

And our rules say awards of costs are unlikely to be common because in most cases complainants should not need professional advisers to bring their complaint to our service. I understand why Mr F wanted to seek professional help but I don't think that's a cost he needed to incur in order to raise his complaint with DAS or with our service. So I don't think this is a case in which an award for costs would be appropriate.

Mr F's representatives have also queried why I'm not able to award interest on any payment that DAS makes. My power to award interest is provided by s229 of the Financial Services and Markets Act 2000 which provides:

229 Awards.

...

(2) *If a complaint which has been dealt with under the scheme is determined in favour of the complainant, the determination may include—*

(a) *an award against the respondent of such amount as the ombudsman considers*

fair compensation for loss or damage ...suffered by the complainant ("a money award");

...

(8) A money award—

(a) may provide for the amount payable under the award to bear interest at a rate and as from a date specified in the award; and

It follows that I'm only able to award interest on a 'money award' (for example where we're directing a business to make a payment for financial loss). That isn't the case here.

Putting things right

DAS will need to reconsider the costs claimed by Mr F in line with the policy terms and will be entitled to take into account the requirement to only pay reasonable and necessary costs.

Once DAS has calculated its outstanding liability it will need to subtract from that the amount which relates to its costs recovered as part of the settlement agreement. It should calculate that on the basis of an 80:20 split in Mr F's favour (meaning its recovery would be £32,800).

DAS can then apply any remaining terms and conditions of the policy including of course the indemnity limit.

DAS will also need to pay Mr F £200 in recognition of the distress and inconvenience he was caused as a result of his claim being incorrectly turned down.

My final decision

I've decided to uphold this complaint. DAS Legal Expenses Insurance Company Limited will need to put things right by doing what I've said in this decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr F to accept or reject my decision before 2 January 2024.

James Park
Ombudsman