

The complaint

H complains that Ecclesiastical Insurance Office Plc (“EIO”) has unfairly declined a claim it made under a charity and community connect insurance policy.

H is a non-profit organisation. Any reference to H or EIO includes its respective agents or representatives.

What happened

The background of this complaint is well known to all parties. So, I’ve summarised events.

- H holds a policy with EIO that was taken out through a broker (Company A).
- H’s property was damaged as a result of arson.
- Following EIO’s investigations, it accepted the claim. But it said H had underinsured the property. The declared value of the property for the purposes of the policy was £273,004. But EIO said the correct value should’ve been around £580,000. As a result, EIO settled the claim proportionately.
- H agreed to a cash settlement in the circumstances and sought to find funds to meet the shortfall for any repair costs.
- H brought its complaint to this service, saying it was unhappy with EIO’s use of the average clause and that it had been left without around £15,000. It also complained that EIO had unfairly included a shed within its insured sum calculations. And it said it was misled into accepting a settlement as it wasn’t clear this was inclusive of VAT.
- One of our investigators looked into what happened and upheld the complaint. She said the definition of buildings within the policy included any outbuildings. So, she was persuaded EIO had acted fairly when including the shed within its calculations.
- The investigator said the declared value sum used by EIO was inclusive of VAT – which was unusual within the industry. She said the policy definition did not mention this inclusion, so it was unfair for EIO to include VAT within its calculation of value. She also said the VAT in question amounted to around £15,000 which was significant. And that EIO’s response that there was no evidence to show H wouldn’t incur VAT within its reinstatement was wrong, as the sum insured, and the cost of reinstatement were two separate and distinct concepts.
- So, the investigator said EIO should recalculate the declared value of the property excluding VAT, then in turn the average clause in light of the revised declared value. EIO should then pay the difference between what was paid, and what should’ve been paid, with 8% interest on the additional sums from the date of initial payment until settlement.
- H agreed, but EIO didn’t. EIO said:
 - H had previously agreed to its valuation at risk (“VAR”) figure of £579,216 (inclusive of VAT at 20%) via its loss assessor. And it would’ve expected this to be challenged at the time – and because it didn’t this shows H was aware

and accepted VAT would be included to arrive at the correct VAR figure.

- H is not VAT registered so was unable to reclaim VAT from HMRC.
- Its policy definition of declared value includes the required cost of reinstatement of buildings. And it is general public knowledge that, when purchasing goods or services, that VAT will be added when arriving at their cost. So, it said for a policyholder to ignore VAT, would mean sums insured would be inadequate.
- VAT being added by insurers for the purposes of declared value/sum insured was common industry practice (as confirmed by its loss adjusters), especially in the commercial market.
- H was represented by a professional broker – so they had received the benefit of professional insurance advice. It said if the policyholder incurs a VAT liability on the reinstatement works it will pay the VAT, subject to proof of the liability to pay and subject to application of average which it is entitled to do because of the underinsurance in the declared value for buildings.
- EIO disagreed with the Service's use of 8% interest and suggested a lower sum of no more than 5%.

So, the complaint has been passed to me for an ombudsman's 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'm upholding this complaint. I'll explain why.

Use of average clause

In this case all parties appear to be in agreement that H's property was underinsured.

When this happens, an insurer may choose to "*apply average*" to the claim under an "*average clause*". This means that where the sum insured is inadequate, the insurer can reduce its liability for a claim by applying a proportionate approach. EIO's policy includes a term that allows for this.

So, I'm satisfied EIO is able to do this in line with the terms of its policy.

Scope of VAR

H had previously raised concerns about a shed being included within EIO's calculation of VAR. I understand H has now accepted our investigator's assessment that it was fair for EIO to include this as outbuildings were included within the policy's definition of buildings. For completeness, I'm in agreement with our investigator that this is the case, and I'm satisfied it was reasonable for EIO to include the shed for this reason.

VAT within sum insured

The crux of the complaint that is outstanding sits with whether it is reasonable to have expected H to include VAT within its sum insured / declared value.

Declared value is defined within the policy as:

“the cost of reinstatement of the buildings insured at the level of costs applying at the inception of the period of insurance (ignoring inflationary factors that may operate subsequently) plus an allowance for:

- *the additional costs of reinstatement*
- *professional fees*
- *debris removal costs*

as insured under the Additional Fees and Costs extension to the Buildings section of this policy.”

Reinstatement is defined within the policy as:

“the rebuilding, replacement or repair of property damaged to a condition that is equivalent to, or substantially the same as, but not better or more extensive than its condition when new.”

This means the declared value should include the cost of rebuilding, replacing, or repairing a property to the position it was in prior to the loss (subject to the terms included). And I would note that this specific policy doesn't specify that the declared value includes VAT.

EIO has argued that there was no evidence to show H *wouldn't* incur VAT within its reinstatement and therefore should be included within the sum insured. And that the cost of rebuilding a property necessarily includes VAT.

But not all contractors that a consumer might use, or specifically H in this case, to get the work done will be registered to charge VAT. In addition, while VAT is charged on new buildings, this is subject to many exemptions including homes and certain buildings used for charitable purposes.

For these reasons, I'm not in agreement in that this is the standard expectation when providing this figure as EIO has suggested. And looking at professional standards and guidance in this area, there is an expectation to make this clear. And moreover, it specifically hasn't included this point about VAT factoring into its calculation within its policy, as it had with other costs like professional fees and debris removal costs.

So, I'm not satisfied EIO has acted fairly in this case by using the VAR sum inclusive of VAT. And I'm directing it to recalculate the declared value of the property *without* VAT. It should then reapply its average clause using this revised declared value. EIO should then pay the difference between what was paid, and what should've been paid, with 8% interest on the additional sums from the date of initial payment until settlement.

Interest

EIO has disputed the figure of interest suggested by our investigator at 8% simple.

We award interest at 8% simple for a few reasons. This includes 8% being the current rate used on judgment debts, and because people often have to pay a higher rate than this if they've borrowed money to cover a loss – for example, on a credit card.

While I've taken on board EIO's concerns, this is the established approach of this service and its points haven't changed my mind.

Putting things right

EIO must:

- Recalculate the declared value exclusive of VAT.
- Reapply the average clause relevant to the correct declared value.
- Pay the difference between what should have been the correct cash settlement and what has already been paid.
- Pay 8% interest per annum on the difference from the date of payment of the initial cash settlement to the date of settlement.

My final decision

My final decision is I uphold this complaint. Ecclesiastical Insurance Office Plc must follow my above direction to put things right.

Under the rules of the Financial Ombudsman Service, I'm required to ask H to accept or reject my decision before 30 November 2021.

Jack Baldry
Ombudsman