DRN-3142403

The complaint

Ms D complains that U K Insurance Limited ('UKI') hasn't treated her fairly after she made a claim on her commercial insurance policy.

What happened

Ms D runs a bed and breakfast. Following a leak at the property, she made a claim on her bed and breakfast insurance policy. The policy was taken out in June 2020. She says the repairs are estimated to cost about £15,000.

Following a visit, UKI raised concerns Ms D had significantly underinsured the property when taking the policy out, by only giving a rebuild value of £2,000,000 ('£2m'). During her online application she gave a figure of £2.2m, but in the follow up call, this was reduced to £2m.

In response, Ms D provided UKI with a page from a survey that was completed in 2014. The survey stated the 'estimated rebuild cost for insurance purposes' was £1.5m. UKI offered Ms D £50 to apologise for some delays, and it noted her survey would be considered.

Further delays followed, for which UKI offered to increase the compensation to £300. Due to its continued concerns, UKI decided to commission its own valuation survey (which cost £4,500). The survey estimated the rebuild value to be £10.8m.

By the time of UKI's survey, Ms D had already brought her complaint to this service. UKI told our investigator it was unable to make a claim decision at this time, and it said it had asked Ms D to produce her own survey to support why she disagrees with the survey it had commissioned.

UKI noted the policy hadn't renewed as its underwriting criteria will only accept properties up to £5m. However, UKI said it would honour any claims whilst this matter is ongoing if Ms D hasn't been able to obtain insurance elsewhere.

Our investigator thought the complaint should be upheld. This was because she didn't think Ms D had made a misrepresentation when taking the policy out. She thought UKI should settle the claim for the damage. She was only aware UKI had offered the initial £50 compensation, and she thought the compensation should be increased to £500.

Ms D asked our investigator about her lost income. She noted that she had not been able to run her business from the property due to fear of not being covered in the event an incident occurred. In November 2021, Ms D estimated she had so far lost about £25,000. However, in January 2022, she estimated her losses to be £45,000 to £55,000. Our investigator told Ms D she would need to make a complaint about her financial losses to UKI before our service could consider the matter.

UKI disagreed with our investigator's findings. UKI said it wasn't alleging misrepresentation, but it needed to understand the correct sum insured as the claim would be settled on an 'average' basis. In other words, because the 2m sum insured is only 18.5% of UKI's estimated 10.8m rebuild cost, it would only pay 18.5% of the claim.

Because UKI disagreed with our investigator's findings, the complaint was passed to me for a final decision. I've since had correspondence with UKI. I'll set out the content of our exchange within my below findings.

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.

Can UKI apply an average?

In my correspondence with UKI, I explained that, whether UKI has alleged misrepresentation or not, misrepresentation legislation is the relevant law that applies. Because Ms D's policy is a non-consumer contract, the Insurance Act 2015 is the relevant legislation. I also noted that the policy terms covering underinsurance uses the same language and follows the approach of the Act. Those policy terms are set out in the general conditions under the heading 'fair presentation of the risk'.

To summarise, the Act explains:

- Ms D had a duty to make a fair presentation of the risk.

- If Ms D breached her duty, and the breach is 'qualifying', there are specific remedies available to UKI depending on whether the breach was 'deliberate or reckless', or 'neither deliberate or reckless' (also referred to as 'innocent').

- A breach is deliberate or reckless if the policyholder knew they were in breach of their duty, or they didn't care whether they were in breach.

- A breach is qualifying if, but for the breach, UKI wouldn't have entered into the contract, or would have done so on different terms.

So, the first part of the test is whether Ms D breached her duty to make a fair presentation of the risk. The Act sets out the following:

a. Ms D had to disclose every material circumstance which she knew or ought to have known – or failing that, Ms D had to give sufficient information to put a prudent insurer on notice that it needs to make further enquiries;

b. Ms D had to make disclosures in a reasonably clear and accessible manner; and

c. every material representation made as a matter of fact must be substantially correct, and every material representation made as a matter of expectation or belief must be made in good faith.

I set out the following to UKI:

- Ms D was relying on a 2014 survey when she gave a rebuild value of £2.2m. The survey covers her entire property and it was produced by a chartered surveyor, so I find it credible. Whilst the survey was completed six years before the policy was taken out, Ms D accounted for that by increasing the rebuild value from £1.5m to £2.2m.

- In terms of ‘a’, Ms D disclosed the information she knew or ought to have known. I’ve not seen anything that leads me to conclude Ms D ought to have doubted the 2014 survey. The Act explains Ms D ought to know what should reasonably have been revealed by a reasonable search of the information available. Here, a seemingly credible survey from 2014 was available to Ms D.

- In terms of ‘b’, I’ve not seen that Ms D didn’t make disclosures in a reasonably clear and accessible manner.

- In terms of ‘c’, I’ve listened to the post on-line application call, in which the cover was taken out. During the call, the sum insured was reduced from £2.2m to £2m. Ms D also noted the rebuild costs were between £1.6m and £2m. It’s clear from the call Ms D wasn’t making a statement of fact, but rather, a statement of expectation or belief. As per the 2014 survey, that statement was made in good faith.

- Therefore, I said I haven’t seen Ms D breached her duty to make a fair presentation of the risk.

In response, UKI noted it wasn’t relying on the policy condition that Ms D must make a fair presentation of the risk. UKI said it was relying on a different policy term that explains an average will be applied to the claim settlement if the sum insured is less than 85% of the rebuild cost.

UKI also said because it’s applying the ‘average’ policy terms, it doesn’t have to demonstrate there’s been a breach of fair presentation. Nonetheless, UKI said it believed there had been a breach as the survey relied upon was six years old, and given the specialist nature of the property, UKI would expect a more up to date rebuild valuation.

UKI also said Ms D failed to inform it her business was for sale, and this was a material fact that would need to be disclosed. UKI says had it known about the intended sale, its further investigations may have led to the full facts and risks becoming known, which would have prevented the risk being accepted.

UKI said, in summary, applying an average is a provision in the policy terms that it’s entitled to apply regardless of the reason for underinsurance. UKI said, the Insurance Act hasn’t removed or overruled ‘the principal of average’.

I accept Ms D’s policy contains ‘average’ terms. I also accept the principle of applying an average has been in place long before the Insurance Act. However, since the Act came into force in August 2016, insurers should be following the approach set by that law.

Simply because a policy has ‘average’ terms, doesn’t mean the terms take precedence over the relevant law. Particularly if applying those terms leads to a less favourable outcome for the policyholder.

The Act does allow the insurer to ‘contract out’. To summarise, the insurer can include policy terms that puts the policyholder in a worse position than the Act, providing certain conditions are met. The insurer must take sufficient steps to draw the disadvantageous term to the policyholder’s attention before the policy is taken out, and the term must be clear and unambiguous as to its effect. Unless those conditions are met, a term which puts the policyholder in a worse position than the provisions of the Act, is of no effect.

I've not seen anything that shows UKI brought the 'average' terms to Ms D's attention before the policy was taken out. In any event, simply highlighting the terms wouldn't go far enough, in my view. UKI would need to explain the implications, in respect of the terms in question being applicable rather than the Insurance Act. Furthermore, I don't find the policy terms clear and unambiguous in respect of which principles UKI is seeking to follow. I say this because its own general conditions follow the wording and the approach of the Act.

So, I'm satisfied that the Insurance Act applies to Ms D's claim, rather than the 'average' terms in her policy.

In respect of the rebuild value, for the reasons I've explained above, I don't consider Ms D to have breached her duty to make a fair presentation of the risk, even *if* UKI's survey provides a more realistic estimate.

In respect of Ms D's property being for sale, I accept she had to volunteer information, as per the test I set out above. However, I'm not persuaded she knew, or ought to have known, the intended sale was material to the risk. In any event, UKI hasn't said it wouldn't have offered her cover if it had known about the intended sale, and I've not been told anything that leads me to believe more information would have been sought about the rebuild value had she notified UKI the property was for sale (which is listed for 1.7m). Therefore, even *if* by not volunteering information about the intended sale Ms D can reasonably be said to have breached her duty, I'm not persuaded that breach would be qualifying.

So, to summarise, in respect of the rebuild value, I'm satisfied Ms D had met her obligations under the relevant law; and in respect of the intended sale, even if there was a breach, I'm not persuaded it would be qualifying. I'm also not persuaded UKI had 'contracted out'. In those circumstances, the law offers no remedy.

It follows that I don't consider UKI can fairly rely on a policy term that's leads to an outcome which is contrary to the law. So, in conclusion, I'm satisfied UKI must consider the claim up to the policy limits that apply, without applying an average to the claim settlement.

As I understand it, Ms D has been able to complete some of the repairs. However, I haven't seen any invoices for the repairs completed; it isn't clear what repairs are outstanding; and I've not seen quotes for the outstanding repairs. As such, I'm unable to make a monetary award.

In the event Ms D is unhappy with the settlement amount offered after UKI has considered the claim, or with its decision about items claimed for, she can make a further complaint about those matters.

If UKI accepts the repairs completed so far are covered as part of the claim, it will need to pay 8% simple interest per annum from the date Ms D paid the invoices to the date of settlement.

Should UKI cover Ms D's financial losses?

Ms D says she's lost income of £45,000 to £55,000 since the leak. As I understand it, Ms D's hob and oven isn't fully working due to the water damage, and she therefore says she can't provide breakfasts. I also understand Ms D was unconformable taking bookings. Although UKI assured her it would honour future claims whilst this dispute was ongoing, she didn't have any confidence given UKI's position on this claim. She also says she was unable to obtain insurance elsewhere as UKI didn't cancel her policy, and another insurer wouldn't have offered her cover whilst this claim/investigation was ongoing. I make no findings on those points, but I set them out for the benefit of the parties.

UKI has requested the financial losses be treated as a new complaint, so it can *"complete a thorough review".* Overall, I find UKI's request to be reasonable. I say this because, I've not seen sufficient information and/or arguments at this stage to reasonably decide what, if any, financial losses should be covered. I also don't consider it appropriate for me to pre-empt UKI's decision. I'm more persuaded that it's in Ms D's interests to have UKI consider the matter first. Our service can then consider the arguments made, via a new complaint, if she's unhappy with UKI's decision.

As such, should Ms D accept my final decision, UKI will need to consider whether her policy covers financial losses as a result of the water damage, and if not, whether it should cover some of the financial losses due its delays in settling the claim. UKI will also need to consider the evidence Ms D is able to provide to support her financial losses.

What compensation should UKI pay?

The claim was made in November 2020. So, irrespective of financial losses, I'm satisfied that Ms D should be compensated for the disruption caused by the settlement delays, the upset caused by the prospect of only receiving a partial settlement, and the inconvenience of having to pursue the matter.

Our investigator recommended £500 compensation be paid, in total. Overall, I don't consider £500 goes far enough in respect of acknowledging the claim delays and the impact on Ms D. I acknowledge UKI paid £4,500 for a survey to move matters forward, and in doing so it was endeavoring to treat Ms D fairly. However, as explained above, I'm satisfied UKI should, in the first instance, have applied the approach set out in the Insurance Act. The 'average' approach taken was to Ms D's detriment.

Having considered matters carefully and bearing in mind the claim delays are significant, I'm increasing the compensation to £1,000. I understand UKI has already paid £300 compensation. If so, a further £700 would be due.

My final decision

For the reasons I've set out above, I uphold this complaint.

My final decision is U K Insurance Limited should:

- consider Ms D's claim for water damage, up to the policy limits, without applying an average to the settlement (should Ms D be unhappy with the settlement offered, or with its decision about items claimed for, she can make a further complaint);

- pay 8% simple interest per annum on the repairs already completed by Ms D, if those repairs are accepted as part of the claim, from the date she paid the invoices to the date of settlement;

- consider whether Ms D's policy covers financial losses as a result of the leak, and if not, whether it should cover some of her claimed financial losses due its delays in settling the claim (should Ms D be unhappy with its decision, she can make a further complaint); and

- pay Ms D £1,000 compensation, in total (if £300 has already been paid, a further £700 would be due).

If UKI considers that it's required by HM Revenue & Customs to deduct income tax from any interest paid, it should tell Ms D how much it's taken off. If requested, it should also provide her with a certificate showing the amount deducted, so she can reclaim it from HM Revenue & Customs if appropriate.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms D to accept or reject my decision before 10 June 2022.

Vince Martin
Ombudsman