DRN-3757384

The complaint

Mrs L and a company that I'll refer to as E are trustees of a trust which I'll refer to as L. The trustees have complained that AXA Insurance Plc unfairly reduced the settlement on L's commercial property insurance claim due to the property being underinsured.

Mr L has helped to bring this complaint. For ease of reading, I will refer to Mrs L throughout this decision.

What happened

L held a policy with AXA for a property which it owns and rents out as offices. In August 2020 the property was damaged by a flood, so L claimed on its policy.

AXA appointed a loss adjuster to look into the claim. The loss adjuster thought Mrs L had provided a lower reinstatement value for the property than she should have done when buying the insurance for L. The loss adjuster said Mrs L had declared the reinstatement cost as £692,641 when he estimated it to be £997,000.

The loss adjuster said the policy included an average clause which meant that if the property was underinsured any claim could be reduced accordingly. This meant that the loss adjuster thought L's claim of £19,616 should be reduced to around £15,000. As Mrs L disputed the reinstatement cost suggested by the loss adjuster, AXA appointed a valuation surveyor to assess L's property. This surveyor said that the reinstatement cost was £1,117,700 and this meant that the property was underinsured by more than the loss adjuster had suggested. As a result, AXA said that L's property was only insured for 61% of what it should have been insured for and reduced the amount it paid to settle the claim to £11,270.84, after deducting the excess.

Mrs L didn't think this was fair and brought a complaint to our service. She said that she had told AXA that the property was made of stone so it should have taken that into account when calculating the risk. Mrs L said she had initially based the valuation on a surveyor's report produced when she bought the property in 2014. This estimated the reinstatement cost to be £598,000. Mrs L said that AXA had increased the amount insured each year for inflation and She thought this would be adequate. Mrs L also didn't think the reinstatement costs given by AXA's experts were realistic. Mrs L provided a report from a different surveyor, dated October 2021, who said that the reinstatement cost was £475,000. In addition, Mrs L said that the loss adjuster had agreed the repair costs and she had acted on this. Mrs L said she could have reduced costs if she had known they wouldn't be agreed.

Our investigator looked into Mrs L's complaint and recommended it be upheld. He thought that Mrs L had made AXA aware that the property was made of stone and made a fair presentation of the risk when buying the policy. Therefore, he thought AXA should pay L's claim without making any adjustment for the average clause, as well as paying a further £200 for the inconvenience caused.

AXA didn't agree. It said it wasn't relevant whether it knew that the property was built of stone, as it was still for Mrs L to provide an accurate reinstatement estimation. It remained

persuaded by its expert's estimations but said it would offer a settlement of £13,722.34 which was based on the average of its two experts' reports. AXA also said that it hadn't agreed to the repairs going ahead and had made it clear there could be an issue with underinsurance.

As AXA didn't agree with our investigator, the complaint was passed to me for a decision.

I issued a provisional decision on this complaint on 28 September 2022 explaining why I intended to uphold it. In that decision I said:

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

AXA has said that Mrs L was underinsured, as the reinstatement value of the property covered in the policy was significantly less than the true reinstatement cost. Because of this, it's said it will apply the average clause in the policy and offer a proportionate settlement.

AXA has said that Mrs L is underinsured based on information she provided when renewing the policy in 2019. So that's what I'm going to consider, and in doing so will take account of the relevant law as well as what is fair and reasonable in all the circumstances. Mrs L's policy is a commercial one so the law that applies here is the Insurance Act 2015 (the Act).

When considering a complaint where underinsurance is alleged, before considering the policy terms, I must first consider the Act. Under the Act a commercial customer has a duty to make a fair presentation of the risk to the insurer. 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. If it is found that they didn't fulfil this duty then in order to say there has been a qualifying breach, the insurer needs to show that it would have either not offered the policy at all, or offered it on different terms.

So, I've first considered whether Mrs L made a fair presentation of the risk. I'm going to focus my decision on the renewal which took place in November 2019, as this is the policy which was in force at the time of the claim. To do this, I've considered the information that AXA sent to Mrs L before the policy renewed.

The Schedule states that the property reinstatement value is £692,641. There is information provided next to this value which states that this should be the cost of reinstating the property as new from the start of each period of insurance and include fees associated with the building. I think AXA provided clear information here about the costs it wanted to know about so Mrs L should have been reasonably clear about what she was being asked.

The renewal letter let Mrs L know that the sums insured had been increased to reflect inflation. Although the letter goes on to say that if the sums insured aren't correct, the policyholder should let AXA know as this could result in them being underinsured, I don't think the letter made it clear to Mrs L that any increase for inflation might not be enough to ensure that her property was properly insured. I understand that Mrs L estimated the reinstatement cost based on the surveyor's report she received when buying the property.

The surveyor is RICS registered and I haven't seen anything to indicate that this value wasn't appropriate at that time. I have taken into account that this report was from 2014, but given that the sums insured on the policy are increased for inflation and it wasn't clear that this wouldn't be sufficient, I think it was reasonable for Mrs L to think that the sum insured remained appropriate and for her to think she'd provided a reasonable estimate based on what was known at the time. Also, if AXA required a new estimate to be completed each

year it could have specified this.

I appreciate that Mrs L could have obtained an updated report to ascertain the reinstatement value of her property. But if she'd done so, I think it would likely have been along the same lines as the one she obtained in 2021 which would have confirmed her belief that the amount she'd declared was appropriate.

I've noted Mrs L's point that she declared to AXA that the property was built of stone. While that's not the issue in dispute here, in my view it supports that Mrs L was trying to ensure that AXA had all the information it needed to decide on which terms it wanted to insure the risk.

I have also considered Mrs L's point that her surveyor's report is more accurate and therefore she declared the correct reinstatement cost. I think this is unlikely given that the reinstatement value provided in the report is less than when she bought the property and I think it's unlikely that the reinstatement cost would have decreased. Also, her surveyor is out of line with the loss adjuster and valuer and I think the two with more similar costings are more likely to be accurate.

However, I don't think I need to make a finding on this because I'm considering what Mrs L knew, or ought to know, at the time she renewed her policy. And when taking everything into consideration I think Mrs L made a fair presentation of the risk. I think she told AXA everything she knew, or ought to know, that would influence the judgment of an insurer in deciding whether to insure the risk and on what terms. As I'm satisfied that Mrs L made a fair presentation of the risk, AXA doesn't have any remedies to reduce the value of the claim under the Act.

Contracting out from the Insurance Act

In this case AXA instead relied on the average clause in the policy and offered to settle the claim at 61% of its value. It is quite normal for a policy to include an average clause. However Section 17 of the Act lays out the requirements for insurers to present this clearly.

It states as follows:

> *"The transparency requirements*
> *(1) In this section, "the disadvantageous term" means such a term as is mentioned in section 16(2).*
> *(2) The insurer must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into or the variation agreed.*
> *(3) The disadvantageous term must be clear and unambiguous as to its effect."*

16(2) as referred above states:

> *"16 (2)A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects any of the other matters provided for in Part 2, 3 or 4 of this Act than the insured would be in by virtue of the provisions of those Parts (so far as relating to non-consumer insurance contracts) is to that extent of no effect, unless the requirements of section 17 have been satisfied in relation to the term.)"*

AXA hasn't indicated that it thinks it has contracted out of the Act. And when considering the circumstances of Mrs L's claim, I think the average clause is disadvantageous because it put her in a worse position than she would have been in under the Act. I say that because by applying the average clause AXA would only have to pay 61% of Mrs L's claim compared to

the full amount if it applied Part 2 of the Act.

I've looked at the policy, but I don't think AXA did enough to meet the requirements for contracting out as laid out in the Act. As it has provided no evidence to show that it has specifically highlighted its departure from the law and the possible disadvantage for the customer.

So as I'm not satisfied AXA has done enough to fulfil the requirements of the Act in relation to contracting out, I don't think it's reasonable for it to rely on the average clause in the policy to settle this claim. For this reason I intend to require AXA to settle the claim in line with the Act, rather than the average clause.

As I think Mrs L made a fair presentation of the risk I don't think it would be fair and reasonable for AXA to make any deduction to the settlement. Therefore, I intend to require AXA to pay L's claim without making any deduction for underinsurance. I understand this means that AXA should pay L an additional £8,045.16.

As the claim wasn't settled in full when it should have been L has been without money it should have had. I think it's fair and reasonable to conclude that AXA should have paid L the additional amount when it paid the initial £11,270.84. So I think it's fair and reasonable for AXA to add interest to the £8,045.16 at 8% simple from the date it paid the rest of the claim until the date it makes payment.

I'm not going to comment on Mrs L's point about being told that repairs could go ahead because even if I was to uphold that point it wouldn't make a difference to the outcome of the complaint.

I do, however, think that not having her claim paid in full has caused L inconvenience as it has had to pay an additional £8,000 for repairs that it thought it was insured for. I think £200 is a fair and reasonable amount for AXA to pay to L to compensate for this.

Mrs L said she was satisfied with the decision and didn't provide any further comments.

AXA didn't agree. It said that, having obtained several legal opinions, it didn't think my interpretation on the legal position was correct. AXA didn't think that the Act precluded it from applying the average clause, or that it's necessary for an insurer to follow the contracting out provisions of the Act. AXA said the sum insured is not a material fact as cover will usually be provided. AXA said it can apply the average clause where a property is underinsured and that the Act doesn't override contract law.

Before reaching a final decision, I let both parties know that even if I am wrong about the legal position then I still think this is a fair and reasonable way to consider this complaint.

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 going to uphold this complaint. I'll explain why.

Section 3 (3) of the Act says that a fair presentation of the risk is one:

> *"(a)which makes the disclosure required by subsection (4),*
> *(b)which makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurer, and*

(c)in which every material representation as to a matter of fact is substantially correct, and every material representation as to a matter of expectation or belief is made in good faith."

Subsection (4) says that the disclosure required is:

"*(a)disclosure of every material circumstance which the insured knows or ought to know, or*
(b)failing that, disclosure 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"

Section 7 of the Act (3) says that:

"*A circumstance or representation is material if it would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms.*"

I've considered AXA's point that it doesn't think the sum insured is a material fact and therefore the Act doesn't apply. As set out above, the Act refers to both facts and expectations or beliefs. I consider an expectation or belief is something that isn't a fact and that's supported by the Act differentiating between matters of fact and matters of expectation or belief. I think the estimated reinstatement cost is a matter of expectation or belief as it's difficult to know exactly what it would cost. So I think the Act applies to Mrs L's declaration of the estimated reinstatement cost of the property.

AXA says it will usually enter into the policy irrespective of the reinstatement cost, but I think that in some cases the sum insured, which is meant to represent the cost of rebuilding a property, might impact whether an insurer decides to offer the policy or not. I also note that AXA said it will *usually* enter in the contract, it does not say that it always will. Moreover, in my experience, the reinstatement cost will generally impact the cost of the policy. AXA hasn't told us that it would have offered the policy for the same premium if Mrs L had declared an amount more in line with its professional estimates. So I think the estimated reinstatement cost is likely to impact the terms on which an insurer will offer cover and therefore, it's a material circumstance.

For completeness, I would add that if I'm wrong and AXA wouldn't have charged a higher premium if Mrs L had given a higher reinstatement cost then I wouldn't think it would be fair and reasonable for it to reduce the settlement for underinsurance. I say this because if AXA would have insured the risk at the same cost then I consider that the average clause would only benefit AXA and not L and AXA wouldn't have experienced any financial loss at the point of the sale from the information provided by Mrs L.

I've noted AXA's points that it doesn't think that the Act precluded it from applying the average clause, or that it's necessary for an insurer to follow the contracting out provisions of the Act. However, I've set out my reasons for this within my provisional decision and I haven't seen anything from AXA in response to my provisional decision to persuade me to change my mind.

As set out in my provisional decision, I don't think AXA can apply the average clause if it hasn't fulfilled its requirements with regard to contracting out of the Act. I consider that Mrs L made a fair presentation of the risk when buying the policy and therefore I don't believe that AXA has a remedy available under the Act.

Fair and reasonable

However, even if I am wrong about any aspect of the legal position set out above, I still think that considering L's complaint in the way set out in my provisional decision produces a fair and reasonable outcome in the circumstances of this complaint.

I say this because Mrs L took reasonable steps to make sure the reinstatement cost was accurate, and I believe that she acted in good faith. L's policy didn't require Mrs L to get new valuations each year and AXA increased the sum insured by inflation. Mrs L based her original estimate on a valuation, and I don't think she had any reason to suspect she hadn't given a fair figure to AXA at the renewal. In these circumstances I don't consider that it would be fair for AXA to nonetheless reduce her claim significantly on the strength of professional valuations she didn't – and wouldn't – have had access to when renewing the policy.

So, in this particular case, I don't think it would produce a fair and reasonable outcome for AXA to reduce the settlement of L's claim due to the reinstatement cost not being what AXA believe it should be.

Therefore, I'm not persuaded to depart from my provisional findings and have set out how AXA should put things right below.

Putting things right

It remains that I think the fair and reasonable outcome to this complaint is for AXA to:

- Pay L an additional £8,045.16 so that L's claim is paid without any deductions for underinsurance (less any of the additional amount AXA might have already paid towards the total amount of the claim).
- Add interest to the additional amount of £8,045.16 at a rate of 8% simple per year from the date AXA paid the £11,270.84 until the date it makes payment.
- Pay L £200 compensation for the inconvenience caused.

My final decision

For the reasons set out above, my final decision is that I uphold this complaint and require AXA Insurance UK Plc to do as set out in the 'Putting things right' section above.

Under the rules of the Financial Ombudsman Service, I'm required to ask L to accept or reject my decision before 24 January 2023.

Sarann Taylor
Ombudsman