DRN-4055985

The complaint

G complains about the settlement offered by Aviva Insurance Limited after a claim on its property insurance policy following a fire at a property it owns.

Mr B is the director of G and has brought the complaint on its behalf. Throughout this complaint Mr B has been represented by a third party, however for ease of reading all references to Mr B include the actions of his representative.

What happened

G has a property insurance policy that's underwritten by Aviva for a property it owns and rents out. The property consists of a restaurant on the ground floor and residential flats on the floors above.

In 2019 there was a fire in the restaurant that caused substantial damage to the ground floor of the building. G made a claim on the insurance which was accepted. The required repair work began and Aviva made interim payments for G to cover the costs. However in May 2020 G presented the total costs for the repairs and Aviva raised concerns that the property was under insured. It said the cost to restore the restaurant was nearly the same as the total amount insured for the rebuild of the whole property.

It subsequently said that the property had been under insured as the rebuild cost had been declared as £724,686, which it said was not a reasonable estimation of the cost. It therefore said the average clause in the policy would apply. This meant the value of the claim would only be paid out at a proportionate rate based on the level of under insurance.

To calculate this it arranged a valuation of the property to estimate the rebuild cost. It valued the rebuild at £1,416,000. G disputed this and had its own valuation completed which calculated the cost as £1,060,000. Due to the discrepancy Aviva said it would settle the claim based on an average of the two valuations - £1,122,660. It said the property was insured for 65% of this valuation, so it would pay this proportion of the claim that equated to £489,281.

Mr B didn't think this was fair. He said that the valuation provided by Aviva was far too high and therefore it wasn't fair that it based the calculations on this. He also said that Aviva hadn't mentioned the problem of under insurance until nearly a year into the claim, when he had already spent money on repairs and committed to reinstating the building. He made a complaint to Aviva on G's behalf.

Aviva didn't change its position so Mr B brought the complaint to this service.
Our investigator considered the issues but didn't recommend the complaint be upheld. She said she thought Aviva had acted fairly by applying the average clause in the policy. And she thought that Aviva only had reason to believe the property was under insured on receipt of the quote for the total repairs to the restaurant. So it was reasonable that it only raised concerns at that stage of the claim. She also thought Aviva had acted reasonably by agreeing to value the property at an average between the two valuations obtained.

Mr B didn't agree with our investigator's opinion. He said he didn't think the rebuild amount provided at the inception of the policy was unreasonably low at the time. And thought it wasn't fair that Aviva accepted the claim to begin with and then applied the average clause 11 months into the claim. He asked for the complaint to be reviewed by an ombudsman.

In October 2022 I issued a provisional decision. In this, I said:

- While I noted the average clause in the policy, I thought it fair to first consider whether Aviva had fulfilled its duty under the relevant law – the Insurance Act 2015.
- 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.
- Mr B had valued the rebuild of the property at £724,686 when he took the policy out, however he had a valuation for just the ground floor restaurant that indicated the true cost would exceed this sum from two years before he took out the policy. I therefore concluded that he ought to have known the estimate he provided for the rebuild wasn't a reasonable one.
- Aviva provided evidence to show that it would have charged a higher premium if it had been provided with a reasonable estimate for the rebuild cost, I therefore concluded there had been a qualifying breach under the Insurance Act.
- Under the Act, in these circumstances, it allows the insurer to settle the claim on a proportionate basis based on the proportion of premiums that were paid, compared to those that should have been. I calculated that based on this, the Act required Aviva to pay 81% of the claim rather than the 65% it had offered.
- I also considered whether Aviva had done enough to meet the transparency requirements in order to 'contract out' of the Act. As part of these, Aviva was required to make the term, and any potential disadvantageous impact of the fact it departs from the relevant law, clear to its customer at the point of sale.
- I concluded that while the average clause was clear in the policy, it wasn't clear that applying this term is a departure from the law and may be disadvantageous to its customer. I therefore didn't agree Aviva had met its obligations under the transparency requirements.
- I also considered the fact that Mr B was a sophisticated customer due to the fact he owned a property portfolio and that he bought the policy through a broker. But I didn't think Aviva had provided enough evidence to show that it had made the term clear to the broker, and it was ultimately Aviva's responsibility to do so.
- I therefore concluded that it wasn't fair for Aviva to rely on the average clause and it should settle G's claim under the remedies available in the Insurance Act, settling it at 81% of the total cost rather than 65%.

Since I issued my provisional decision, Aviva has provided additional evidence relating to the information and training it provided to G's broker prior to the inception of the policy. Based on this, I re-considered whether it met its obligations under the transparency requirements.

On 14 March 2023 I issued a second provisional decision in which I stated:
'Under the Insurance Act, where a term is disadvantageous, in order to contract out an insurer must meet the following requirements:

'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.'
(4) In determining whether the requirements of subsections (2) and (3) have been met, the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account.
(5) The insured may not rely on any failure on the part of the insurer to meet the requirements of subsection (2) if the insured (or its agent) had actual knowledge of the disadvantageous term when the contract was entered into or the variation agreed.'
(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.')

I explained in my provisional decision why I thought the term in the policy would be disadvantageous. As G would be at a disadvantage when the term is applied compared to when the Act is applied – which I demonstrated in my calculations of the settlement. I therefore consider that the transparency requirements need to be met in order for Aviva to contract out from the Insurance Act.

Here, the policy was sold to G through a broker, that I'll refer to as "J". Therefore under the Act if Aviva can show that J – acting as G's agent here – had actual knowledge of the disadvantageous term at the time it sold the policy to G then this would meet the requirements.

I've also considered comments from The Law Commission Report on Insurance contract law that was published in 2014, the recommendations of which were implemented through the Insurance Act 2015. This stated as follows:

'29.42 Where the insured is using a broker, we think drawing the broker's attention to the disadvantageous term would be sufficient. In many instances there will be little or no direct contact between the insurer and the insured, with everything being done through intermediaries. In such a situation, it is the broker's responsibility to ensure the insured is aware of the term. This is not specified in the draft Bill, but is a matter of general agency law.'

Since my provisional decision, Aviva has provided evidence of the information and training it provided to J as part of its relationship with the broker. All of which was provided before the inception of G's policy. This included a number of detailed references and discussion about the average clause, the average waiver and underinsurance more generally. Alongside a statement from its account manager that looked after its relationship with J. The evidence included:

- *Discussion between J and Aviva during the initial tender about the policy which includes numerous references to the average clause, the average waiver and Aviva's valuation service.*
- *Specific discussion around the average clause and potential changes to the wording of the policy in relation to this.*
- *Specific reference to the support Aviva provides its customers in obtaining accurate valuations in order to avoid underinsurance.*
- *Slides from training sessions delivered to J by Aviva that specifically reference underinsurance and valuations.*

Further, Mr B has provided a copy of the proposal J sent him that recommended Aviva's

policy for G. This document contains direct reference to the average clause and waiver in the policy as part of a nine point list of the main features and benefits.

Based on this evidence, I think Aviva has now done enough to show that it drew the term to J's attention. And that J, as G's agent, had actual knowledge of the average clause in the policy and its possible consequences at the time the policy was sold to G.

For this reason, based on this new evidence, I think Aviva has done enough to meet the transparency requirements and to contract out from the Insurance Act.

The Average clause in the policy states as follows:

'Where a Sum Insured is stated to be subject to average, this means that if at the time of Damage, the Sum Insured is less than the total value of the Property Insured, You will be responsible for the difference and bear a proportionate share of the loss.'

In my provisional decision, I explained why I was persuaded that the estimate Mr B provided for the sum insured when the policy was taken out wasn't a reasonable one based on the information he had available to him at the time. I also explained that I thought it fair that Aviva use the average of the two valuations – G's and its own. And I see no reason to depart from these conclusions.

As I'm now satisfied that Aviva has done enough to show it met the transparency requirements I therefore think it's applied this term fairly. And find that its settlement offer of 65% of the full claim cost is a fair one.

I note that the policy also contains an 'average waiver' that removes the average clause where certain conditions are met. The policy states as follows:

'We will not make an adjustment for Average condition irrespective of what may otherwise be stated in the Basis of Claim Settlement Clause that may be applicable to the Building(s) item where You have

(1) taken all reasonable steps to ensure that the Building(s) item Sum Insured is adequate, and
(2) obtained a valuation for the Building(s), that has been calculated as the cost of reinstating the Building(s) as defined within the Policy Definitions including debris removal costs and associated professional fees, from a Royal Institution of Chartered Surveyors professional or such other person agreed by Us within the three years prior to the date of the Damage, and
(3) adjusted the Sum Insured in line with the valuation, and
(4) made annual adjustments of the Sum Insured based on the General Building Cost Index issued by the Building Cost Information Service of the Royal Institution of Chartered Surveyors or alternative index as may be agreed by Us in writing.
We will request a copy of the valuation at the time of a claim.'

While a valuation was received by Mr B in around 2016, this indicated that the sum insured would have been significantly higher and I've seen nothing to suggest that Mr B took any action to adjust the sum insured in line with that valuation. I am therefore satisfied that the waiver wouldn't apply in these circumstances.

For these reasons, I think Aviva has acted fairly and reasonably by applying the average clause in the settlement of G's claim. It's shown it's done enough to meet the transparency requirements to contract out of the Insurance Act and I am persuaded that the average waiver wouldn't apply in this instance. I am therefore minded not to uphold this complaint or

ask Aviva to do anything further.'

Response to my second provisional decision

Mr B responded to my provisional decision with the following points, which I have summarised:

- The information Mr B had available to him when he incepted the policy suggested the rebuild value of the property was £500,000 which was significantly less than the sum insured. So he had made a fair presentation of the risk from the start of the policy and hadn't made a qualifying breach under the Insurance Act.
- He didn't agree that J had a clear understanding of the average clause in the policy, which was demonstrated by unclear wording around the average waiver provided in the initial proposal document.
- I said the average waiver wouldn't apply because the valuation he had at inception showed the sum insured should have been higher, which Mr B says wasn't the case so doesn't agree the average waiver wouldn't apply.

Aviva responded to my provisional decision. In summary it said:

- Aviva's position is that the Insurance Act is of no legal relevance to the average clause in the policy and this wasn't reflected in my decision.
- It asked for specific wording to be added to the decision to properly reflect this.

I have considered all points raised by each side when reaching my final 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.

I've considered what Mr B has said about the adequacy of the sum insured when the policy was incepted. And while I agree the amount on the valuation he obtained was less than the declared rebuild value on the policy, this valuation was only for the ground floor restaurant and one of the residential units. Whereas the building was made up of the commercial unit and three residential units. The valuation indicated that the approximate rebuild cost was around £500,000 for the two units alone and the market value was £1,045,000 when occupied and £875,000 when vacant. When the policy was set up a rebuild cost of £724,686 for the entire property was provided. So whilst the rebuild cost for two of the four units was lower than the sum insured, this wasn't a valuation of the property in its entirety. So Mr B should have known this wasn't a true reflection of the rebuild cost of the whole property.

Further, the declared value of the property was below the amount specified in this valuation, so I think Mr B ought to have known the information he provided at inception wasn't a true reflection of the full value and rebuild cost of the property.

But regardless of the value given at inception. Both sides are in agreement that the property was underinsured at the time of the claim. And while the valuations provided from each side vary, they are both over the amount insured. So regardless of whether the property was underinsured at inception, it was certainly underinsured at the most recent policy renewal to the claim – in September 2018 – and at the time of the claim. And this means Aviva is entitled to take some action.

I've also considered what Mr B has said about the average waiver and for the reasons I have already laid out above, I don't agree the valuation obtained in 2016 was enough for Mr B to be sure that the rebuild cost and value given at the inception of the policy was correct. But regardless the average waiver also requires the valuation to be from within three years of the claim, and it specifies that it must be from a certain specified surveyor and the valuation obtained in February 2016 by Mr B met neither of these criteria. So I'm satisfied that the average waiver wouldn't apply to G's claim.

Further, I've considered what Mr B has said about J's knowledge of the average clause in the policy. Mr B has said that the proposal sent to him when switching his insurance to Aviva stated that the policy provided: 'Average free buildings cover where a RICS valuation has been carried out in the last 3 years.' He's said that this shows J didn't have a proper understanding of the average term in the policy, as the average waiver only applies when the valuation was carried out within three years of the damage that gave rise to a claim and this isn't what J described.

I've considered this but it doesn't change my position. In this complaint, I'm considering whether J had actual knowledge of the 'disadvantageous clause' in the policy as described in the Insurance Act. I'm not considering anything in relation to the sale of the policy or the information provided at the point of sale.

In particular, I'm considering whether point 5 of the transparency requirements has been met:

'(5) The insured may not rely on any failure on the part of the insurer to meet the requirements of subsection (2) if the insured (or its agent) had actual knowledge of the disadvantageous term when the contract was entered into or the variation agreed.'

And the following extract of The Law Commission Report on Insurance contract law that was published in 2014:

'29.42 Where the insured is using a broker, we think drawing the broker's attention to the disadvantageous term would be sufficient. In many instances there will be little or no direct contact between the insurer and the insured, with everything being done through intermediaries. In such a situation, it is the broker's responsibility to ensure the insured is aware of the term. This is not specified in the draft Bill, but is a matter of general agency law.'

The fact that J quoted the average waiver in its initial proposal shows that it had actual knowledge of the clause in the policy. And I've considered this alongside evidence provided by Aviva about the training and information it provided J about the policy before the inception. And based on all the evidence I remain persuaded that Aviva did enough to ensure J had actual knowledge of the term. I understand Mr B thinks J didn't make it clear exactly what the requirements of the average waiver were in its proposal document, however this isn't the determination I am making here. I just need to be satisfied that J had actual knowledge of the term. I laid out in my second provisional decision why I'd been persuaded that it did, and I've seen nothing new that persuades me otherwise since.

Finally, Aviva has said that it feels I didn't address its key objection that the Insurance Act is of no legal relevance to the application of the average clause and has suggested I add some specific wording to my final decision in order to satisfy it that I have addressed this point. In both my first and second provisional decisions I laid out why I thought the Insurance Act was relevant to this complaint about under insurance, including why the clause was disadvantageous and the conditions that need to be met under the Act in order for an insurer

to meet the transparency requirements and formally contract out of the law. So I don't agree I need to add anything further on this point.

So after considering everything again, including the responses to my second provisional decision, I see no reason to depart from my findings as laid out in that decision. I therefore don't uphold G's complaint and think Aviva has acted fairly and reasonably by applying the average clause in the policy to the claim settlement.

My final decision

For the reasons I've given, I don't uphold G's complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask G to accept or reject my decision before 27 April 2023.

Sophie Goodyear
Ombudsman