DRN-4552622

The complaint

Ms J has complained about her commercial property insurer Arch Insurance (UK) Limited regarding claims she made following water damage during storms.

What happened

Ms J made claims to Arch. She wasn't happy with how they progressed and made a complaint to the Financial Ombudsman Service. Following one of our Investigators assessing the complaint in September 2021, the claims resumed.

Around that time Arch had asked to visit the premises to review the finishings in place at the property. This was because it was considering a tender analysis received for reinstatement work. It had also identified a possible issue with underinsurance.

Access to the property was granted in December 2021. Arch made an initial offer of settlement to Ms J in January 2022. Ms J made a counter-offer in February 2022, with Arch responding in March 2022, with its own counter-offer, based on a compromised value for underinsurance (part way between the values used in its initial offer and those from Ms J's counter-offer). This was followed by two further counter-offers from Ms J and Arch setting out (what it has since referred to as) its final position on the claim on 27 June 2022. That letter concluded, confirming that some payments had already been made to Ms J but offering a further "interim" settlement of £179,120. Ms J asked for that sum to be paid but she believed there was more still reasonably due to be paid by Arch under the claims.

In September 2022 Ms J formally set out her complaint to Arch. Arch issued its final response letter (FRL) to that complaint on 28 October 2022. It felt there was nothing more for it to pay. Ms J brought her complaint to the Financial Ombudsman Service in March 2023.

During the course of our complaint process, Ms J identified an additional offer made by Arch in November 2022. Our Investigator explained that we couldn't take that offer into account when considering the September 2022 complaint because we could only look at what had happened and what Arch's position was as at the date of its FRL issued in October 2022.

Regarding the complaint points Ms J had raised in September and Arch had answered in October 2022, Ms J confirmed which were outstanding for her, that she wanted us to consider. Having considered those points, our Investigator felt Arch had failed Ms J in some of those respects. He felt there were a number of things Arch should do to put things right, including recalculating its claim settlement and paying £300 compensation.

Arch agreed to our Investigator's recommendations. Ms J felt they did not go far enough. Particularly she felt it was unfair that Arch had ignored the tender recommendation and that it had raised underinsurance so late into the claims. She also felt £300 compensation did not fully recognise the distress and inconvenience caused to her. Her complaint was referred for an Ombudsman's consideration.

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 find my view on the complaint is the same as that set out by our Investigator. I acknowledge there are a number of complaint points. Whilst my background above is brief, I can confirm I am aware of everything which has happened and I've taken into account all of the arguments made, as well as the evidence submitted. But as this is an informal service my summary and findings focus on the issues and evidence which I consider to be key or central to the complaint.

I know some evidence from Ms J regarding energy costs is pending. But that is detail she would need to submit to Arch in the first instance anyway, so I'm not persuaded to hold my decision on the complaint as a whole for that to become available. Further, as our Investigator explained, this complaint considers issues, including Arch's claim handling, between October 2021 and the October 2022 FRL.

Basis of settlement

The reinstatement work was put to tender by a structural engineer. Bids for the work were considered and in the engineer's report on the tender process, contractor "L" was recommended. When Arch made its offers of settlement it used figures set out by another contractor, "P". P had returned the lowest of the tender bids. Ms J felt that was unfair, that L's figures should form the basis of settlement. Arch said the policy doesn't require it to pay the higher sum of Ms J's preferred contractor.

The policy requires Arch to cover reinstatement costs. Arch argues that is satisfied by it settling based on P's price. And having reviewed the tender report there is nothing which makes me think P could not do the work. Rather it was recommended that Arch pay the higher costs returned by L because it was situated closer and could start work sooner. By the time settlement was being discussed several months later in 2022, neither of those points held much relevance. The report said L was a specialist. But for P to be involved with the tender process, it seems to me as though it would've had to have been able to complete this type of work. I also note the tender process involved ensuring the final prices returned were "robust". I think if it was felt P would be unable to complete the work to a good standard for the prices returned, it would have been discounted from the tender process. The report does also record that Ms J's preference was for L to be appointed.

If the tender process had returned serious issues for concern with P's bid, I might be minded to say Arch should reasonably have to pay in-line with the recommendation made. But that is not the case here. I'm satisfied that it was reasonable for Arch to base its settlement on the price returned by P.

Fixtures and fittings

Ms J's policy with Arch covers her for 'landlord's fixtures and fittings'. She says there is lighting at the property, CCTV and surround sound, which she installed as landlord. Arch has declined to offer settlement for these items. Its FRL explains that was initially because it didn't view them as fixtures. But then an issue of ownership arose because Ms J, it said, hadn't shown that she had installed them. It pointed to her lease agreement with the occupier of the premises not detailing this fact.

This service would often consider that items attached to the fabric of the building are fixtures. A common example might be fitted appliances, whereas freestanding appliances would be more normally considered contents items, not fixtures of the building. The details of the items in question here are a little more complex, where wiring and cables may be hidden in

the walls. But sometimes a review of how the items are being used and who can be shown to own them can help determine whether the items should fairly and reasonably, in the given circumstances, be considered to be fixtures.

Here Ms J owns the building. But she is also the sole director of a limited company, which is her tenant in the building. The lighting system certainly, seems to be designed for the purpose of the limited company's business. I also note that Ms J has not been able to show payments coming from her own personal accounts to pay for any of the three items to be purchased and/or installed. Further, as highlighted by Arch, the lease agreement does not set out these items as being something the landlord is responsible for.

I've considered a letter provided by Ms J from her accountant. This was provided to assist in evidencing her ownership of the lights. However, the letter doesn't reference the accountant having worked for Ms J at the time the lights were purchased, nor does it show any official record of their purchase or installation costs. The accountant says it is their "understanding" that Ms J paid for and installed the lights personally before the limited company was incorporated. Overall I don't find this document to be persuasive evidence that Ms J most likely owns the lights.

On this occasion, I can see why Arch made the decision it did. I'm satisfied that Arch's conclusion, that it has no liability for settling for these items, is fair and reasonable.

Underinsurance

I think Arch acted reasonably when stating there was underinsurance. But I'm also satisfied that the approach and figures it then applied were flawed. Meaning its settlement, overall, was unfair and unreasonable.

When arranging or renewing the policy, Ms J had a duty to make a fair presentation to Arch of the risk she presented as a prospective or renewing policyholder. Ms J was asked to give a declared value for the property, which the paperwork provided by Arch explains meant its rebuild value. Ms J arranged the cover via a broker, so Arch wasn't responsible for directly highlighting that detail to her. Ms J gave a declared value of £572,014. During the claim both Arch's and Ms J's own surveyor found the rebuild value for the property was significantly (by at least £100,000) more than that. Given the very significant difference in the values and that Ms J hasn't shown she took care in providing the value she did, I'm not persuaded Ms J, in giving the value she did, made a fair presentation of risk.

Because Ms J did not make a fair presentation of the risk, Arch is entitled to act as it would have done had a fair presentation been given. In this case Arch has confirmed it would still have offered the cover – but at an increased price. The relevant law – the Insurance Act 2015 – provides that Arch then can compare the premium it did charge against the one it would have done, and settle the claim based on the percentage of cover provided by the premium paid. Whereas Arch calculated the underinsurance by determining the percentage difference between the declared value Ms J gave and the rebuild sum determined by surveyors (Ms J's and its own).

Arch's surveyor determined the rebuild cost at over £750,000. With Ms J's finding a value of around £700,000. In a letter of June 2022 Arch said it would take the correct rebuild value as an average of those two sums. Arch has explained its surveyor used some specific calculations – meaning its sum was likely the most accurate – but acknowledges that Ms J's applied a lower sum for professional fees. Meeting in the middle of two experts' calculations, seems fair and reasonable to me.

I know that Arch has shown that, based on its surveyor's rebuild cost, it would have charged Ms J around 13% more. I think it should recalculate the premium it would have charged,

based on the average rebuild cost of £726,384.37 (£754,543.22 plus £698,225.52, divided by two). It should then set the recalculated premium against the premium Ms J was charged, of £906, to determine what percentage of cover Ms J had paid for. The claim value can then be reduced by the percentage which she had not paid for. I appreciate that this is different to what the policy allows for – but it is what the Insurance Act allows for, which Arch has not opted out of ('contracted out') – and Ms J shouldn't be subjected to a policy a term which leaves her in a worse position than that allowed for by legislation. That would be unfair.

I am also aware that Ms J has argued that its unfair for Arch to rely on any underinsurance to limit its settlement because it only raised the issue late in the claim process. I would generally expect an insurer to be live to the idea of policy liability issues like this from the outset of the claim. But that's not to say that, in each and every claim an insurer must determine if there is underinsurance at the outset – and if it doesn't it can't do so later. That could create unfair outcomes – not least in terms of delaying claims. Rather each complaint about a delay like this has to be considered on its own merits.

Here I can see that at the point my consideration of matters begins, October 2021, the tender process had completed and the figures returned had sparked a concern for Arch about underinsurance. I see it wanted to investigate that and an assessment was completed in December 2021, with Ms J being told of the outcome in January 2022. I'm satisfied that Arch acted in a reasonably timely manner in this respect. I don't think it did anything which would give me reasonable cause to say it fairly can't view Ms J as underinsured.

Delays

I think Arch handled the claim in a reasonably timely manner in the period October 2021 to October 2022. I see it wanted to investigate the underinsurance and it did that within a couple of months. It then advised Ms J of the underinsurance and made its first offer of settlement in early January 2022, with Ms J then seeking the involvement of her own surveyor. As set out in my background, counter-offers by both parties were subsequently made. With Arch then making a sizable payment to Ms J of £179,120 in June 2022.

I know that payment was billed as an interim payment – and Arch later said there was nothing further due. There will be now, following this decision. But I don't think Arch sought to mislead Ms J by calling it an interim payment. Regardless of quantum an interim payment indicates that the matter is not resolved. Which it wasn't here. The interim status allowed Ms J to take the money whilst pursuing her complaint, with Arch initially, and then, following its October 2022 FRL, this service.

Having reviewed the relevant claim activity, I think Arch handled matters reasonably. I think it considered the available evidence and offers, replying in a timely manner each time. As I've noted, the quantum of its final settlement was unreasonable, but at its heart – paying based on P's costs and accounting for underinsurance, the settlement had a fair basis. And I don't think the quantum issue caused an unreasonable delay in itself because Ms J has always insisted L's costs should be used, whereas I'm satisfied Arch using P's was fair.

Professional fees

At one stage Arch did offer to settle based on professional fees being paid at 13 per cent of the contract price. The company organising the tender process also said that is what it would charge if it remained involved. But it said that if it did not remain involved, it wouldn't be providing certain services that were factored into the 13 per cent figure. So it would only charge 60 per cent of that 13 percent, meaning a deduction of 40 per cent would apply. Which was the final basis of what Arch offered Ms J. I don't think that was fair.

Arch, when settling in cash, would be entitled to settle based on the cost to it to do the work. Which would likely have been the full 13 per cent – because it would likely have needed the

type of project management to be provided which the 40 per cent deduction was made in respect of. So, in my view, a reasonable settlement from Arch would be based on a professional fee of 13 per cent of the contract price, subject to the adjustment for underinsurance.

Storage costs

Arch covered storage costs for Ms J up until October 2022. It wasn't prepared to cover costs of storage beyond that point. By this time Arch had made settlement payments to Ms J and confirmed its final position on the sums in discussion. And Ms J had made it very clear that she wouldn't accept a settlement unless it was based on L's sums, with no deduction for underinsurance.

As I've noted above it was fair for Arch to not use L's figures and for it to apply some deduction for underinsurance. So whilst the quantum of Arch's final position was not fair, its being based on P's cost (rather than L's) and subject to underinsurance was. Which means Ms J was never likely to have accepted it even if the quantum itself had been fair. There was clearly a lot of negotiation which went on in 2022, and the claim continued over a number of months. But settlements were made to Ms J.

The fact that Ms J wasn't able to progress with repairs, such that storage costs would continue was not, in my view, due to any failure of Arch. As such I think Arch's position in its October 2022 FRL – that it would not pay anymore storage costs – was fair and reasonable.

VAT

Arch's settlement didn't include VAT. I can understand why that would be a concern to Ms J. But I can assure her it is quite normal for property insurers to not settle VAT sums until VAT is due. And it usually only becomes due at the point of work completing. Arch's FRL indicated it would consider reimbursing VAT once Ms J became liable for paying it. I'm satisfied that Arch acted fairly and reasonably regarding VAT.

Energy costs

Arch previously said it had no knowledge of Ms J having incurred energy costs – that it had paid all it had expected to be due by settling its contractor's invoices for drying the property. I'm not persuaded that was a wholly reasonable response – not given its contractors, as standard, would use the energy provision at the property to fuel its appliances used for drying. There's a natural cost to the policyholder in that (assuming they are responsible for paying bills at the property), which most insurers will readily acknowledge.

However, that does not mean that Arch should just pay Ms J what she says is owed. Ms J has said most drying contactors taking readings, she feels Arch's should have done that here, and if they didn't, that would be its fault. But even if readings were taken, what a bill payer is charged for energy usage can vary substantially. So it isn't generally felt to be unreasonable for insurers to ask for bill details to help it determine what is reasonably owed for the usage recorded. If usage wasn't recorded that wouldn't automatically mean the insurer, by default, must reasonably pay whatever sum the policyholder tells it they incurred. The policyholder would still be expected to reasonably evidence their loss. Arch has asked in its FRL of October 2022 to see proof of payment. Ms J has said she is expecting to receive energy bills any time soon. I'm satisfied its reasonable for her to share these with Arch for its consideration.

Legal costs

Ms J instructed solicitors to deal with her claim, as well as her complaint to Arch. She'd like Arch to refund her costs. It is the general approach of this service that we don't usually award legal fees. This is a free, informal service and complainants do not need to be legally represented to use our services. This was a complex claim but the process for complaining

is not complicated. I'm not persuaded there's any fair or reasonable basis for me to step away from our general approach and require Arch to reimburse Ms J's legal fees.

Loss of rent

Ms J had a lease with her limited company which made the limited company liable for rent of £25,000 per year. She claimed from Arch on this basis – with her policy with Arch offering cover for 24 months of lost rent (£50,000). Arch asked Ms J to show the amounts she'd received in rent. That was £5,000 a year only, every year but one since 2013, including a payment about one-month before the loss occurred (the exception was 2016 when £6,000 was received). In the second year after the loss, Ms J had not received anything. Arch felt Ms J's only loss then, for the 24-month period covered by the policy, was £5,000. But it felt she had acted fraudulently, so it declined the loss of rent claim altogether.

I bear in mind that, strictly speaking, in the two-years after the loss, Ms J did not receive the rent agreed in the lease. And her policy with Arch covers her for 'rent receivable'. Arch fairly had to consider what sum Ms J would likely have received but for the loss. But, whilst it established that was much less than what she had claimed for, it hasn't, in my view, shown that Ms J knew she was making an untrue claim. I bear in mind that she cooperated with it fully – providing it all the detail it asked for. Taking everything into account, I think its most likely that Ms J had no intent to gain a benefit she was not otherwise entitled to. As such I'm satisfied that Arch's accusation of fraud was unfair and unreasonable. Arch should, therefore, remove the record of fraud from its own and any industry database. I think it should also settle the loss of rent claim in the sum of £5,000, plus interest.

Claim handling and compensation

In October 2021 Ms J had been asked for access to her building in order that a previously completed VAR calculation could be ratified, mention was made of the claim potentially being subject to average. But I don't think this was clear enough to put Ms J on notice about how her claim would be affected. Such that when the offer was made in January 2022 – with the underinsurance explanation not given much prominence or delivered with any warning – I think she was likely caused upset and worry. I think Arch could have handled the underinsurance issue in this respect more sensitively, ideally it would have noted earlier on in the claim that there *might* be an issue. If it had, Ms J could have been put on notice. But even handling things better in October 2021 would have prevented some of the upset which I'm satisfied occurred when she was told of the limited settlement.

Her upset would have been further mitigated if Arch had fairly determined the quantum of the settlement. As I've said, Ms J would likely still have been unhappy, as the fair settlement I'm satisfied was due, is still less than what she would like. But the sums involved here are significant – so the worry attached to an unfair settlement is more than minimal too.

Arch also, as I've set out above, unfairly and unreasonably accused Ms J of fraud. I accept that caused her worry and frustration.

I know Ms J has been worried about the tone of Arch's communications. But I note that Arch and Ms J were both dealing through solicitors at the time. It doesn't surprise me that the tone was quite defensive and that the language used was not that I'd usually expect to see if an insurer was writing directly to its policyholder.

I'm aware that Ms J has said she was told, by the engineer which Arch paid for, that the loss adjuster had promised the engineer other work if they became involved with this claim. I can see that might worry Ms J. But I haven't seen that the engineer did gain extra work through any arrangement reached with Arch/the loss adjuster. Nor have I seen that Ms J's claim was negatively affected by the engineer's involvement.

So I think that, in some respects, Arch didn't handle the claim fairly and reasonably. In saying that I emphasise that I am not looking at the whole claim journey. Only at what happened, and the upset which was caused between October 2021 and October 2022. I'm satisfied that Ms J was caused distress and inconvenience during that period as a result of Arch's unfair and unreasonable actions. I think this was caused at times over several months of the year or so period I am considering. I bear in mind that Ms J also had a solicitor dealing with matters for her, meaning she was shielded somewhat from the inconvenience caused by having to manage the claim negotiations herself. Taking everything into account, I'm satisfied that £300 compensation is fairly and reasonably due.

Putting things right

I require Arch to:

- Recalculate its proportional cash settlement offer in line with the difference between the premium Ms J paid and what she would have paid if she'd declared a reinstatement cost of £726,384.37.
- Increase the settlement offer for professional fees to represent 13% of the final contract sum (subject to the above proportional deductions).
- In respect of the above two items, also pay Ms J 8% simple interest* per annum on the difference between its previous offer and the settlement sums now to be paid, calculated from the date of the previous settlement to the date settlement is made.
- Remove the record of fraud from its own and any industry database.
- Pay Ms J £5,000 to settle the loss of rent claim, plus 8% simple interest* per annum applied from the date she was due to receive the rental payment to the date of settlement.
- Pay Ms J £300 compensation.

*Interest is at a rate of 8% simple per year and paid on the amounts specified and from/to the dates stated. HM Revenue & Customs may require Arch to take off tax from this interest. If asked, it must give Ms J a certificate showing how much tax it's taken off.

My final decision

I uphold this complaint. I require Arch Insurance (UK) Limited to provide the redress set out above at "Putting things right".

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms J to accept or reject my decision before 14 March 2024.

Fiona Robinson
Ombudsman