DRN-4635186

The complaint

K – a limited company – is complaining about the amount Covea Insurance plc has paid to settle a claim it made on its commercial insurance policy.

What happened

In December 2022 a cart damaged a property K owned. So K contacted Covea to claim on its insurance policy. Covea accepted the claim, but said it would only pay 52% of the claim because it said K was underinsured. K thought this was unfair and referred its complaint to this Service.

Our investigator upheld this complaint. She said Covea had relied upon a term in K's insurance policy that said it can reduce the claim settlement by paying the percentage of the sum insured against the cost of repairing the property – the term is often referred to as the "average clause". However, she said this Service will also consider whether the insurer would pay a different settlement if it had followed its rights under the Insurance Act 2015 ('the Act'). She said Covea hadn't shown what it would charged if K had declared an adequate sum insured. So she said Covea should pay the higher of the settlement payable under the average clause or the proportion of premium K paid against the premium it should have paid.

The investigator also noted Covea had offered K £100 in compensation for the delay in initially handling the claim. And she thought that was fair.

Covea didn't agree with the investigator. It said the policy term was clear and it was entitled to rely upon this. It also thinks the language of this term means it's contracted out of the Insurance Act. And it asked for an ombudsman to review 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.

I've decided to uphold this complaint for the same reasons as the investigator. I'll now explain why.

I'm satisfied that Covea has reasonably shown that the sum insured K has requested (£125,000) is significantly below the property's estimated rebuild value. The sum insured is the most an insurer will pay out on a claim – which is generally the rebuild value of the property. Covea has used a well-established calculator from the Building Cost Information Service to calculate how much it would reasonably cost to rebuild the property – £237,000.

It isn't unusual for insurers to include an average clause in a commercial property insurance policy which entitles it to reduce a value of a claim accordingly. Given the differences in the sum insured and the estimated rebuild cost, Covea has said K's property was only insured for 52% of what K should have insured it for. So K reduced the amount it paid to settle the claim accordingly.

I'm satisfied Covea has applied the term of the policy accurately in line with its rights. But this Service will always consider what's fair and reasonable and – in particular – whether a strict application of a term will result in an unfair outcome. And in doing so, I've taken into account the terms of the policy, industry regulations and the law. As I said, K's policy was a commercial policy so the law that applies here is the Act.

When considering a complaint where the insurer is alleging underinsurance, 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 the insurer can show that the policyholder 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 K made a fair presentation of the risk when declaring the sum insured. I think K needed to provide a reasonable estimate of the cost of rebuilding the property. Given what I've said above, I'm not persuaded it did. So I'm satisfied K didn't make a fair presentation of the risk. If K doesn't believe it was made clear what it needed to do to provide an accurate sum insured, it will need to raise this with its broker who arranged the policy on K's behalf.

Where an insurer can show there wasn't a fair presentation of the risk – as it has in this case – it has certain remedies provided the breach is what the Act describes as a qualifying breach. For it to be a qualifying breach the insurer has to show it would have offered the policy on different terms or not at all if the consumer hadn't made the breach.

The investigator has asked the insurer a number of times to show what premium it would have charged had K declared an adequate sum insured, but Covea hasn't shown this. Although I am satisfied it's most likely the premium would have increased. So I'm satisfied there was a qualifying breach.

I think the Act would consider this breach to be considered a careless breach. In this case, the Act requires Covea to o settle the claim proportionately, based on the premium Mr K paid, compared to what he should have paid.

I think Covea should have considered what it's required to pay under the Act against what it's required to pay under the average clause to ensure it's treating its customers fairly. Further to this, I think the Act supersedes any term of an insurance policy, unless Covea can show that it contracted out of the Act, which the Act allows an insurer to do so. Covea has said the language in the insurance policy effectively means it's contracted out of the Act. But I don't agree. Section 17 of the Act lays out the requirements for insurers to present this clearly if it wants to contract out of the Act. I'll now set them out.

"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.)"

I think the application of the average clause has the potential to be disadvantageous as it could put K in a worse position than it would have been in under the Act. Crucially, the explanatory notes of the Act specify that such terms will only be valid if the insurer has complied with the "transparency requirements".

I've looked at the policy, but I don't think Covea did enough to meet the requirements for contracting out as laid out in the Act. I haven't seen anything to show that it specifically highlighted its departure from the law and the possible disadvantage this would have to K.

As I don't think Covea did enough to draw the disadvantageous limitation term to K's attention before the policy started, I don't think it can rely upon it.

Putting things right

Given this, I think Covea should have considered whether applying the average clause instead of its rights under the Act would put K in a disadvantageous position. So I think Covea should work out what K would have paid had it declared an adequate sum insured. If, after doing this, it shows that it would have paid K more, it should pay the percentage of the claim based on the proportion of premium K paid against what it should have paid instead of what it said it would pay by applying the average clause.

I note Covea has said it has difficulties calculating what it would have charged. If it cannot show what it would have charged, then it should settle K's claim in full.

If K has already paid to fix the property itself, Covea should pay 8% simple interest on any additional amount it owes K from the date K was out of pocket until Covea pays it. If Covea thinks that it's required by HM Revenue & Customs to deduct tax from that interest, it should tell K how much it's taken off. It should also give K a tax deduction certificate if it asks for one, so it can reclaim the tax if appropriate.

Covea has also offered to pay K £100 in compensation for the inconvenience it caused in first delaying the claim – Covea's loss adjustor took around seven weeks to send its report on the claim. I think this is fair compensation. Covea should pay this to K directly if it hasn't already done so.

My final decision

For the reasons I've set out above, it's my final decision that I uphold this complaint and I require Covea Insurance plc to compensate K in line with my instructions above.

Under the rules of the Financial Ombudsman Service, I'm required to ask K to accept or reject my decision before 1 April 2024.
Guy Mitchell
Ombudsman