Insurance Case Law Update

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Introduction

As expected, the Canterbury earthquakes have resulted in a plethora of insurance litigation. The Christchurch High Court has a dedicated earthquake list to deal with the volume of cases.

In this update, we provide a summary of key decisions issued over the past 12 months. More detailed information on judgments having a wider impact on the insurance sector and the general law is linked to the case names highlighted in the summary table.

Summary Table

Case	Issues	Decision / Principle
Ridgecrest v IAG NZ (CA)	Whether an insured is entitled to the **aggregate value of multiple losses** during the period of insurance	Ridgecrest's policy provided cover for repair / replacement under two alternative clauses – C1 and C2. Ridgecrest's claim had been made under C2, which did not entitle it to the aggregate value of damage caused by each earthquake (or happening). Instead, Ridgecrest's cover was limited to the cost of the uncompleted repairs actually carried out and the cost of replacing the building up to the limit of indemnity. Had the claim been made under C1, the outcome might have been different given the wording of that alternative clause, but it was said to be too late for Ridgecrest to change this. Ridgecrest has leave to appeal to the Supreme Court.
Minister for CER v Fowler (CA)	**Lawfulness of 50% rateable value offer** to owners of vacant land and uninsured improved properties in the red zone	The red zone was lawfully created. The Government's decision to make 50% offers for vacant land and uninsured improved properties in the red zone was not lawfully made because it did not properly address the purposes of the CER Act, which is to enable people to recover from the earthquakes.
O'Loughlin v Tower (HC) Skyward v Tower (HC) Rout v Southern Response (HC)	Whether the **red zone** creates an insurable loss Novel repair methods Rebuild costs	The creation of the red zone did not give rise to a claim under the insured's home policy. The insurer was prevented from paying a (lower) sum for notional repair costs based on a technique that was risky. If the insurer paid the notional rebuild costs instead, this should be based on the (lower) cost of rebuilding at a good site, since the insured had no intention of rebuilding on the existing damaged/vulnerable site. A house is only economic to repair if the actual repair costs

[1] With assistance from Michael O'Brien, Sarah Holderness and Taryn Doherty

Case	Issues	Decision / Principle
		are less than 80% of a full rebuild estimate (Rout).
Zurich v BC 398983 (CA)	Whether sum insured was **inclusive or exclusive of EQC** cover	A clause which provided that "Insurer's liability will be limited to the amount of loss in excess of the Natural Disaster Damage cover" was interpreted in the particular commercial context as meaning the sum insured was inclusive of EQC cover.
University of Canterbury v Insurance Council & Ors (CA)	Whether local authorities can require owners to increase the **seismic strength** of buildings above 34% NBS	A territorial authority cannot require a building to be strengthened to a seismic capacity of more than 34% NBS.
IAG NZ v Jackson (CA)	Whether **"in connection with"** requires a direct causal connection Dishonesty exclusion	The phrase "in connection with" requires some causal or consequential relationship, but it does not need to be a direct or proximate cause. Here, insurers could rely on an exclusion in the insured broker's professional indemnity policy which excluded cover for civil liability in connection with a dishonest act. The broker's apparent dishonesty about whether his client's insurance had been arranged came after his initial inadvertent failure to place the cover in the first place. The broker's client sued after suffering uninsured earthquake damage.
Wild South v QBE (HC)	**Automatic reinstatement**	The particular policies included automatic reinstatement clauses. Cover reinstated automatically if no notice was given within a reasonable period following the first earthquake. What is reasonable will depend on the knowledge and conduct of the parties after each event, but will not normally extend to the date of payment of the first claim.
Avonside Holdings Ltd v Southern Response Earthquake Services Ltd [2013] NZHC 1433	Assessment of **nominal costs of rebuild**	Builders' margin to reflect amount charged by a reasonable contractor, not special rates available under preferred agreement arrangements. Allowances for professional fees should reflect fees necessary for a rebuild of the damaged property, rather than a new build. The assessment can be discounted to take account of reusable parts. No allowance should be made for contingencies.
TJK (NZ) Ltd v Mitsui Sumitomo Insurance Co Ltd [2013] NZHC 298	**Obligation to pay indemnity value** prior to reinstatement	No rule of law that indemnity value is immediately payable when an insured elects reinstatement. On the terms of the policy at issue, the insured was entitled from the date of damage to an indemnity for its loss. The difference between the indemnity value and reinstatement cost became payable when the insured incurred those costs.
Morley v Earthquake Commission [2013] NZHC 230	Whether **boarding houses are entitled to cover** from EQC	A boarding house is a dwelling insured under s 18 of the Earthquake Commission Act 1993.
McLean v IAG NZ [2013] NZHC 1105	Whether rebuild costs include **professional fees**	The "reasonable cost to repair or replace" a house included professional fees.

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Ridgecrest New Zealand Ltd v IAG New Zealand Ltd [2013] 3 NZLR 618

Ridgecrest owned a commercial building in Christchurch that was insured by IAG NZ. The policy provided repair / replacement cover under the following alternative provisions:

> ***C1:*** *This insurance will pay the amount of loss or damage or the estimated cost of restoring your Business Assets as nearly as possible to the same condition they were in immediately before the loss or damage happened using current materials and methods.*
>
> ***C2:*** *Where Replacement cover has been agreed by us and specified in the Schedule and following loss or damage you restore or replace the lost or damaged Business Assets this insurance will pay*
>
> *(a) For Buildings*
>
> *(i) Where repairable, the cost of restoration of damage to the same condition when new,*
>
> *or*
>
> *(ii) If unable to be repaired because of such damage, the cost of replacement by an equivalent building which meets your requirements at any site provided we shall not pay more than the cost of replacement at the Site stated in the Schedule.*

The building suffered damage in each of four Canterbury earthquakes during the period of insurance and was ultimately demolished. It was repairable after the first two earthquakes on 4 September and 26 December 2010, and remedial works had begun when the third struck on 22 February 2011. The parties disagreed as to whether the building became irreparable at that point but agreed that it was beyond repair after the fourth earthquake on 11 June 2011.

Ridgecrest made separate claims after each earthquake. The issue was whether it was entitled to be paid the aggregate value of the damage caused by each earthquake (or 'happening'). IAG NZ took the position that, once the building was irreparable, it was only required to pay the cost of replacement up to the limit of indemnity. The policy contemplated multiple claims during the period of insurance but did not specifically address what would happen when this occurred.

The High Court found in favour of IAG NZ on the basis that the policy had been "frustrated" by the destruction of the building, which rendered IAG NZ's obligation to effect repairs impossible. The High Court implied a term that discharged IAG NZ from paying for losses arising from the earlier earthquakes. In its judgment, the High Court declined to apply the doctrine of merger – ie where there is unrepaired damage followed by total loss, the insured can only recover the total loss. The doctrine exists in marine insurance but the High Court was not convinced that it had any wider application either in this specific case or as a matter of general law.

On appeal, the Court of Appeal reached the same conclusion but by an entirely different route. It drew a distinction between C1 and C2. If the claims had been made under C1, Ridgecrest might have been entitled to payment for the estimated repair costs up to the limit of indemnity after each earthquake. Whereas, under C2, IAG NZ's liability was limited to the cost of the uncompleted repairs actually carried out and the cost of replacing the building up to the limit of indemnity.

In the absence of a clear statement, the Court of Appeal determined that the claims were made under C2. The judgment goes to some lengths to justify this conclusion and to "shut the door" on Ridgecrest subsequently changing the basis of its claims to bring them under C1. The Court observed that the statement of claim did not reference C1 nor allege that the claims were made under C1. Further, it would have defied commercial common sense for Ridgecrest to make a claim for repairs on an old-for-old basis under C1 when new-for-old cover was available under C2. The Court also noted that after the first two earthquakes, IAG NZ assumed responsibility for arranging repairs and met the cost of these. While this was not strictly in accordance with C2, it was indicative of a claim under C2. Had the claims been made under C1, the Court would have expected Ridgecrest to demand payment of its estimated repair costs, rather than acquiescing to IAG NZ's repair arrangements.

The Court of Appeal's reasoning in relation to C2 is somewhat forced. For example, the pleadings appear to have been silent as to which clause applied. What is essentially a pleading point could be "corrected" if Ridgecrest was permitted to amend its statement of claim. The basis of the Court's judgment means that

the decision has limited value as a precedent: were an insured to claim under C1, the outcome may well be different.

The Court of Appeal's conclusion meant it did not need to consider the doctrines of merger or frustration. However, it indicated in obiter that it would not have upheld the High Court's conclusion on frustration, which was based on an implied term, as it was contrary to the express terms of the policy and was not necessary to give the policy business efficacy.

Ridgecrest has been granted leave for a further appeal to the Supreme Court. This will allow the parties to advance all previous arguments, including those on the doctrines of merger and frustration. We will provide a further update once that decision is released.

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Minister for Canterbury Earthquake Recovery & Anor v Fowler Developments Ltd & Ors [2013] NZCA 588

Following the 22 February 2011 Canterbury earthquake, the Government decided to zone Christchurch based on the level of damage and to offer to purchase properties in the worst affected areas known as the ‘red zone’. Areas were classified as “red zone” where rebuilding may not occur in the short-to-medium term because the land was damaged beyond practical and timely repair.

Owners of insured residential properties in the red zone could accept either 100% of the 2007 capital rating value, with all earthquake-related insurance claims being assigned to the Crown, or 100% of the 2007 land rating valuation, with the landowner retaining their ability to pursue their insurance claims (**100% Offer**). By contrast, owners of vacant land and uninsured improved properties in the red zone were offered 50% of the 2007 rating value only (**50% Offer**).

The respondents (who own either vacant land or uninsured improved properties in the red zone) challenged the lawfulness of the red zone and the 50% Offer. They sought the same 100% Offer that was made to owners of insured residential properties.

The respondents were initially successful in High Court, which held that:

a. The red zone had not been lawfully established, because it had not been created using powers under the Canterbury Earthquake Recovery Act 2011 (**CER Act**).

b. The decision to create the red zone did not lawfully affect the property rights of the respondents.

c. The decision to make the 50% Offer was not made according to law, as it had not been made in light of the purposes of the CER Act.

On 3 December 2013 the Court of Appeal gave judgment on an appeal by the Minister for Canterbury Earthquake Recovery and the CERA Chief Executive. It unanimously held that:

a. The red zone was lawfully created.

b. The decision to make 50% Offer was not lawfully made because it did not properly address the purposes of the CER Act.

In particular, the red zone was lawful because it was created using the residual freedom of the executive, it did not affect the legal rights of owners and the decision was not required to be made under the CER Act. The Court described the red zone announcement as the dissemination of accurate information about areas where land damage had occurred, which did not require specific statutory authorisation.

By contrast, the 50% Offer was made by the CERA Chief Executive using his power under s53 of the CER Act. The crucial issue was whether he had properly exercised that statutory power. The Court of Appeal held that he had not done so because the decision was not made in accordance with the recovery purposes of the CER Act, and in particular the purpose of enabling people to recover from the earthquakes.

The Court of Appeal appears to have been persuaded by the plight of the respondents and others in the same position. While there must be sympathy for vacant land owners who could not insure their land, the claims of owners of uninsured improved properties to that sympathy is less clear. Those owners took a risk in not insuring their properties. That risk having eventuated, an argument can be made that they should carry the loss. It remains to be seen whether the Government will seek leave to appeal to the Supreme Court.

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O'Loughlin v Tower Insurance Ltd [2013] 3 NZLR 275
Skyward Aviation 2008 Ltd v Tower Insurance Ltd [2013] NZHC 1856
Rout v Southern Response Earthquake Services Ltd [2013] NZHC 3262

The O'Loughlins' home was damaged in the Canterbury earthquakes (its concrete base was warped) and was subsequently "red zoned".

The O'Loughlins made a claim with their insurer, Tower, for a sum equal to the full cost of rebuilding on the existing site, despite having no intention of remaining there. They also claimed that the creation of the red zone caused loss in respect of which Tower was obliged to provide full replacement cover, regardless of any physical loss or damage. This was disputed by Tower, which sought to discharge its obligations by making a payment based on the estimated costs of repair.

The Court found, first, that the creation of the red zone did not constitute physical loss or damage, and there was no express provision in the policy for economic loss. As a result, the red zone classification did not give rise to an insurable claim.

Second, Tower was required to pay the "full replacement value" of the house, but could elect whether this was on the basis of repair, rebuild or replacement. The sum offered by Tower was based on the notional cost of repair using a 'low mobility grout' injection technique to re-level the concrete base. On the available evidence, there were material risks of complications or failure with this method, which could lead to significant overruns. In light of this, the Court was not satisfied that the sum being offered by Tower equated to the true cost of repair under the terms of the policy.

Tower could instead make a payment on a re-build or reinstatement basis. However, the calculation must be reasonable and in accordance with Tower's obligations under the policy.

If Tower paid a sum based on the cost of rebuilding, this would need to be on the basis of the cost of rebuilding on a good site, and not the (higher) cost of doing so on the existing weakened and vulnerable site. This was because the O'Loughlins had decided not to rebuild on the existing site and both parties had proceeded on the basis of a cash payment to enable the O'Loughlins to settle elsewhere in Christchurch.

The decision in *O'Loughlin* has been followed in the subsequent High Court judgments of *Skyward Aviation 2008 Ltd v Tower* [2013] NZHC 1856 and *Rout v Southern Response Earthquake Services Ltd* [2013] NZHC 3262, which deal with many of the same issues. The Court in *Skyward* clarified that the amount payable by Tower under its option to purchase a replacement house should be based on the fair price of a house comparable to the insured property when new (i.e. on a new-for-old, not old-for-old basis).

The Court's determination on the "red zoning" of earthquake-affected properties in both *O'Loughlin* and *Rout* has set a useful precedent. Meanwhile, the finding in *O'Loughlin* that the low mobility grout method was not feasible and carried risks was specific to the case, and insurers are not precluded from looking at new or innovative repair methods if they are cheaper. However, the evidence in support of those methods will need to be robust from both a technical and costs perspective to discharge an insurer's obligations. The Rout decision provides an interesting insight into the degree of testing that may be necessary to convince a judge of both feasibility and cost.

Many insurance policies employ a test of "damaged beyond economic repair" as the threshold for a full replacement claim. The High Court in *Rout* held that a house is only economic to repair if the actual repair costs are less than 80% of a full rebuild estimate. The judge based this decision on evidence of the standard practice of insurance companies involved in Christchurch earthquake damage claims.

The *Rout* decision provides a warning to both plaintiffs and insurers of the potential dangers of an adversarial approach to insurance claims. The judge criticised various aspects of the insurer's conduct, including its changes of position, the limited scope of the evidence supporting its proposed repair methodology and a lack of transparency in its cost assessments. However the plaintiffs' conduct in pursuing an inflated claim, which was not supported by quantum evidence, disentitled them to a claim for general damages.

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Zurich Australian Insurance Limited T/A Zurich New Zealand v Body Corporate 398983 [2013] NZCA 560

The Salisbury Park Apartment complex in Christchurch, insured by Zurich, was badly damaged in the 22 February 2011 earthquake. The likely cost of reinstatement was $25m, but replacement cover under the Zurich policy was capped at $12.95m. The apartments also had cover under the Earthquake Commission Act 1993 and the maximum amount of $6.8m had been paid by EQC.

The Body Corporate claimed that it was entitled to be paid $12.95m under the policy, in addition to the $6.8m received from EQC (i.e. a combined payment of $19.75m). Zurich said that the Body Corporate's cover was capped at $12.95m in total, $6.8m from EQC and $6.1m from Zurich.

The dispute turned on clause MD15 of the Brokernet policy wording, which read:

> *In the event of the Insured having insured residential property for which compulsory Natural Disaster Damage cover under the Earthquake Commission Act 1993 applies then in the event of such property suffering Natural Disaster Damage during the Period of Cover and covered by Natural Disaster Damage cover, then* ***the Insurers liability will be limited to the amount of loss in excess of the Natural Disaster Damage cover.*** (our emphasis)

It was common ground that MD15 reversed the statutory presumption in s 30(1) of the Earthquake Commission Act that a private insurance policy responds first to natural disaster damage. The question was whether the insurer's liability under MD15 was limited to the *insured* loss in excess of the statutory cover (i.e. the sum insured of $12.95m less $6.8m) or the *actual* loss in excess of the statutory cover (i.e. the reinstatement costs of $25m less $6.8m), subject to the cap of $12.95m.

The factual background to the claim was provided by way of affidavit. The Body Corporate's broker, ACM, had sought quotes from various insurers based on a replacement cost estimate of $12.95m and the Brokernet policy wording. Zurich provided rates, which ACM used to calculate the premium. The premium calculation assumed that Zurich would cover the difference between the statutory cover and the sum insured (i.e. $6.1m).

The High Court found that ACM knew from its market experience that the premium was calculated on a net liability basis and in fact had calculated the premium on that basis. The Body Corporate had engaged ACM for its expertise in the insurance market and ACM's knowledge as an "agent to know" was accordingly imputed to the Body Corporate. As the Court of Appeal noted at paragraph [16] of the judgment, it follows that the parties to the policy agreed that Zurich would provide cover of $6.1m.

As stated by Tipping J in *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] 2 NZLR 444 at [19], the ultimate objective in a contract interpretation dispute is to establish the meaning the parties intended their words to bear. Evidence is assessed on an objective basis, taking into account the commercial or other context in which the contract was made and all facts and circumstances known to and likely to be operating on the parties' minds.

The High Court held that the plain words of MD15 meant that Zurich's liability was measured against the actual loss, not the insured loss. Having correctly stated the test in *Vector*, the Full Court then misapplied it, by focusing on the objective commercial sense of an agreement to provide cover for $12.95m in return for a premium based on $6.1m, rather than the actual intention of the parties (objectively assessed). The Court of Appeal overturned the High Court's judgment: it was apparent from the factual background that both parties intended cover would be limited to the difference between statutory earthquake cover and the sum insured.

The Court of Appeal disagreed with the High Court's view of the plain words of MD15. It is not clear whether the Court took the view that "loss" meant "insured loss" rather than "actual loss", or whether it simply viewed the clause as ambiguous. The lack of clarity in the judgment on that point may limit its usefulness as a precedent.

The Court of Appeal noted that the plainer the words of a contract, the less likely it is that the parties intended them to mean something else and that if, read objectively, the language will not bear the meaning for which a plaintiff contends, a remedy may be sought in rectification (judgment at [35]). The majority in *Vector* made it clear, however, that an unambiguous clause does not preclude a review of the factual context and a displacement of the plain meeting. Rectification is accordingly not necessary to correct drafting or linguistic errors (see Tipping J at [33]), although it remains an alternative to an interpretation argument. The Court of Appeal's view that the meaning of MD15 was not plain and unambiguous should not be interpreted as a precondition to its conclusion on the meaning of the policy in its commercial context.

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University of Canterbury v Insurance Council of New Zealand Inc & Ors [2013] NZCA 471

On 4 September 2010, Canterbury was hit by the first of the major earthquakes to strike the region. On 10 September 2010, the Christchurch City Council adopted a policy that enabled it to require building owners to strengthen existing buildings up to a capacity of 67% of the new building standard (**NBS**). ICNZ challenged the lawfulness of the policy, on the basis that it was inconsistent with the powers given to territorial authorities under the Building Act 2004.

Section 124 of the Building Act gives territorial authorities the power to require work to be undertaken on buildings which are dangerous, insanitary or earthquake-prone. A building is dangerous if it is likely to cause personal injury, death or damage to other property in the ordinary course of events, excluding the occurrence of an earthquake. A building is earthquake-prone if:

a. its ultimate capacity will be exceeded in a moderate earthquake (being an earthquake that would generate shaking that is of the same duration, but is one third as strong as the earthquake shaking that would be used to design a new building at that site); *and*

b. it would be likely to collapse causing injury or death or damage to other property.

The Court of Appeal held that both criteria had to be met before a building was earthquake-prone. The effect of this ruling is that a territorial authority cannot require a building to be strengthened to a capacity of more than 34% NBS, even if the strengthened building has features which make it likely to collapse in a stronger than “moderate” earthquake.

The Court of Appeal quashed a declaration that the Council could require building owners to carry out work to reduce or remove specific vulnerabilities in a building capable of causing injury, death or property damage. The Court noted that there may be no objection to a requirement by Council that specific vulnerable parts of a building be brought up to 34% NBS, but declined to make a ruling on this issue.

The case highlights the tension between the enactment of a nationwide standard and the desire of councils to respond to regional circumstances.

The reports of the Canterbury Earthquakes Royal Commission make it clear that the earthquake sequence in Canterbury was unusual, in terms of the intensity of the shaking and its occurrence in an area previously assessed as low to moderate for seismic activity. Cantabrians have weathered thousands of aftershocks, of which 56 have been of a magnitude greater than 5.0 and three have been greater than 6.0, including the devastating “aftershock” that occurred on 22 February 2011 in which 185 people died.

The evidence considered by the Royal Commission suggested that the performance of unreinforced masonry buildings strengthened to 34% NBS did not perform significantly better in the February event than those that had not been strengthened, although the hazard factor used in strengthening those buildings was lower than it would have been in recognised areas of high seismic activity (such as Wellington). Of the buildings associated with the most loss of life, the PGC building, which had undergone strengthening, was assessed at 30-40% NBS. The CTV building was assessed by experts retained by the Department of Building and Housing at 40-55% NBS. Neither, accordingly, were earthquake-prone.

Buildings strengthened to 67% NBS are less likely to collapse in a major earthquake, but achieving this level of strengthening imposes a significant economic cost on building owners, insurers and the community. ICNZ estimated the cost in Christchurch at several hundred million dollars. The effect on the University’s insurance claim alone was about $140 million.

The cost of a higher standard of strengthening accordingly needs to be balanced against the risk of a major earthquake and its probable outcome. The Commission noted that the magnitude of the 22 February 2011 earthquake was 1.5-2 times higher than the design event for which new buildings are designed. It has been described elsewhere as a 1 in 2,475 year event.

The Royal Commission concluded that the experience of the Canterbury earthquakes did not require a change to the one third rule as a *national* standard, although it recommended raising that standard to 50% NBS for certain elements of unreinforced masonry buildings. However, the Commission recommended that the power be given to territorial authorities to increase the standard in their districts to take into account

specific economic, building or seismic conditions, or where the hazards posed by certain buildings justified a higher standard. Changes to the standard should only be made following the special consultative process in the Local Government Act.

The Commission's recommendations were the subject of a consultative process run by the Ministry of Building, Innovation and Employment (**MBIE**), which concluded in July 2013. The recommendations that power be given to territorial authorities to require a greater level of strengthening than the national standard were not accepted. The standard will accordingly remain 34% NBS throughout New Zealand, although the Building Act will be amended to clarify that only buildings with less capacity are earthquake-prone and to make it clear that the standard applies to parts of a building, as well as the whole.[2]

The University of Canterbury has applied for leave to appeal to the Supreme Court. Regardless of the outcome of that decision, the Government's current intention appears to be that the ability of councils to require earthquake strengthening will be limited under forecast amendments to the Building Act to 34% NBS throughout New Zealand.

The Commission separately recommended that an investigation be undertaken into buildings with characteristics that might lead them to collapse in a major earthquake, so that appropriate steps could be taken to reduce the potential hazard posed by these structures. MBIE is leading a review by councils of 242 buildings with non-ductile columns (a feature shared by the CTV building), half of which were reportedly "cleared" by the end of September 2013. As the law stands, councils do not have power to require changes to buildings likely to collapse in a major earthquake (unless their capacity is less than 34% NBS). It is accordingly unclear what steps will be taken if and when potential hazards are identified. The Minister is taking advice on this issue, as part of MBIE's wider review of the Commission's recommendations.

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[2] The Minister's recommendations are available online at http://www.dbh.govt.nz/UserFiles/File/Publications/Sector/cabinet-papers/epb-policy-cabinet-paper.pdf. The minute of the Cabinet decision is at http://www.dbh.govt.nz/UserFiles/File/Publications/Sector/cabinet-minutes/earthquake-prone-building-policy-cabinet-minute.pdf.

IAG New Zealand Ltd v Jackson [2013] NZCA 302

In May 2009 a Christchurch couple, Mr and Mrs Marchand, engaged Mr Jackson (a broker) to arrange insurance, which he failed to do. This was discovered after the September 2010 earthquake, when the Marchands attempted to make a claim for damage to their home. Mr Jackson's failure to place cover was initially a negligent oversight. However, evidence emerged that he later became aware of this and deliberately failed to remedy the mistake:

- Mr Jackson received the premium from the Marchands but did not pass this on to the insurer or lodge the insurance application.
- Mr Jackson gave assurances to the Marchands that cover was in place when he knew this was not correct.
- When the Marchands made a claim for a pair of spectacles, Mr Jackson had them complete a claim form (which was never lodged) and paid the claim himself.

The Marchands sued Mr Jackson for their uninsured losses. Mr Jackson sought to join his professional indemnity insurer, IAG NZ as a third party. IAG NZ applied for summary judgment on the basis that liability for dishonest conduct was excluded.

The Court of Appeal overturned the High Court's decision by granting IAG NZ summary judgment.

Mr Jackson's PI policy contained an exclusion "… for civil liability in connection with any dishonest, fraudulent, criminal or malicious acts or omissions by [Mr Jackson]…". Mr Jackson argued that his apparent dishonesty was not "in connection with" his civil liability to the Marchands since the dishonesty came after he incurred a liability to them by negligently failing to place cover in the first place.

The Court of Appeal was having none of it. It accepted that "in connection with" requires some causal or consequential relationship. However, the dishonest act did not need to be the direct or proximate cause of the civil liability, nor did it need to precede the liability in time. The Marchands would have secured cover before the earthquake if Mr Jackson had not hidden the truth from them. This was enough to establish the necessary nexus so that the exclusion clause applied.

This interpretation should have a wider application - beyond insurance - since "in connection with" appears in many other forms of contracts. We respectfully agree with the Court of Appeal's analysis, which reflects the commonly understood meaning of this phrase. A narrower interpretation (for example, that there must be a direct causal relationship or that the connection must be "material") might potentially have had widespread and unintended consequences for other contracts.

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Wild South Holdings Ltd v QBE Insurance (International) Ltd and Maxims Fashions Ltd v QBE Insurance (International) Ltd [2013] NZHC 2781

The plaintiffs owned two commercial buildings that were insured by QBE for $3,610,000 and $3,035,700. Each policy included an automatic reinstatement provision in the event of loss, subject to either party giving notice:

> Maxims
>
> *In the event of a loss for which a claim is payable under Part 1, and in the absence of written notice by QBE or the Insured to the contrary, **the amount of insurance cancelled by loss will be automatically reinstated from the date of loss**. The Insured undertakes to pay such pro-rata premium at the rate applicable to the item(s) concerned as may be required for the reinstatement.*
>
> Wild South
>
> *In the absence of written notice by the Insurers or the Insured to the contrary, **the amount of insurance cancelled by loss or damage is automatically reinstated as from the date of loss or damage**. The Insured undertakes to pay such pro rata premium at the rate applicable to the item or items concerned as may be required for reinstatement.*
>
> [Our emphasis]

Both buildings were damaged in the Christchurch earthquakes and the replacement cost of each was assessed at more than $8m – well above the limits of indemnity. Neither party gave notice to preclude the operation of the automatic reinstatement clauses after each earthquake.

The judgment considered a number of preliminary issues regarding the construction of the two policies, including the operation of the automatic reinstatement clauses.

QBE contended that reinstatement only occurs when the amount of insurance arising out of the loss or damage *is paid*. If notice is given prior to paying a claim, the policy will not reinstate and any loss or damage that occurred after the first loss would not be covered. QBE argued that this would not adversely affect an insured person who is fully insured for reinstatement; only those who under-insure (as here) would be affected and the plaintiffs ran that risk when entering into the policies.

The plaintiffs' position was that the policies automatically reinstated on the date of loss and that this could only be set aside by notice *prior to the next event* that causes loss. They pointed out that QBE's interpretation would allow QBE to give notice preventing reinstatement after there had been subsequent events causing loss (e.g. further earthquakes) for which the insureds reasonably assumed they had cover. The plaintiffs argued that this would be commercially absurd.

The Court discussed the general principles of interpretation of insurances policies. Contracts of insurance are to be read like any other contract made in a commercial setting and their meaning should be ascertained objectively, based on what the parties reasonably would have understood the words to mean. The relevant background will drive that assessment.

In this case, the Court did not gain assistance from *Re Earthquake Commission* [2011] 3 NZLR 695 (HC) (a decision founded upon a reinstatement clause that differed from the present wording – where reinstatement was expressly provided for on payment of a claim). Each policy is to be interpreted on its own wording and in its own commercial context. The Court also found that there is no common law of reinstatement in New Zealand that would affect the interpretation of insurance policies in relation to clauses such as these.

The Court found that "automatic" meant that reinstatement would happen automatically i.e. without the need for either party to do something positive to trigger it. Therefore, if neither party gave notice, at some point the cover would automatically reinstate. The problem was that the clauses did not specify a time for the trigger.

The Court rejected QBE's argument that the trigger occurred when the loss from the original event is settled and paid. While the plaintiffs' decision to deliberately under-insure was relevant to the commercial context,

it was not determinative. QBE's interpretation would leave the plaintiffs not knowing whether to rely on the clauses or to seek further insurance from the market, which does not make commercial common-sense.

The Court drew a link between "automatic" and the fact that reinstatement was to take effect from the date of the original loss. This suggested the trigger was intended to happen either immediately or promptly after the loss subject to notice. The Court rejected immediate reinstatement on the basis that the parties must have an opportunity after the loss occurred to analyse the implications and decide whether to give notice. Therefore, to give business efficacy to the clauses, the Court determined that the parties had a reasonable time after the original loss. If no notice was given within a reasonable time, the cover would automatically reinstate.

What is a reasonable period will depend on the knowledge and conduct of the parties after each event (here, each earthquake), which would need to be determined with evidence at trial. However, the Court made it clear that a reasonable period would not extend to completion of the loss adjustment process and payment of the first claim (as QBE had argued).

This case, like many others, will see insurers and brokers revisit their policy wordings. We expect that automatic reinstatement clauses will in the future include a defined trigger – possibly by reference to a specific time period. However, clauses that expressly preclude reinstatement until the original loss has been paid are likely to be unattractive to insureds and could leave them uncertain about whether they need to purchase further insurance following an insurable event.

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