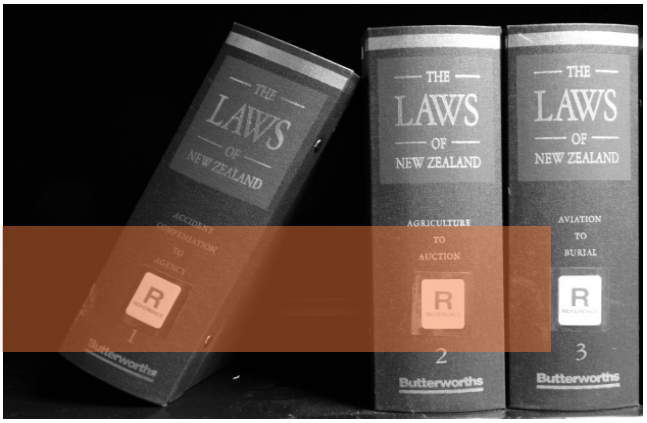

Insurance Case Law Update

By Nick Gillies, Christina Bryant, Stephanie Corban, Sarah Holderness, Hannah Yiu, Michael O'Brien, Nina Thomson, Mary Battersby, Anna Parker, Richard Belcher, and Rob McStay
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Our Insurance Law team has written a new publication for LexisNexis, known as Insurance Practical Guidance. This is the first on-line insurance law product of its kind in New Zealand.

This update provides a summary of judgments released over the past six months. A more extensive discussion of particular judgments is linked to case names highlighted in the summary table. For further information on issues raised in this update, please contact the Hesketh Henry insurance law team.

Case	Issues	Decision / Principle
Christchurch Residential Rentals Ltd v Stanton [2016] NZHC 2936	**Authority to settle** earthquake claims	CRRL purchased 18 earthquake-damaged properties from Stanton. Declaration that CRRL is entitled to settle EQC and insurance claims on behalf of the vendor, provided consent is obtained from Westpac as mortgagee.
Kristinsson v Southern Response [2017] NZHC 456	Joint review of **experts**	Discussion of general approach to expert conferences in the earthquake list. A layered approach may be applied in more complex cases: surveyor excluded from conference of engineers.
Miah v National Mutual [2016] NZCA 590, [2017] 2 NZLR 241 (CA)	Life insurance **Joint policy holders**	Successful appeal against summary judgment. A husband and wife owned a life policy for $2m, payable on the death of the wife. The Court held it was arguable that the policy was owned by the husband and wife as joint tenants, that the tenancy was severed by the husband's bankruptcy, and a half share of the proceeds belonged to the wife's estate. Interpretation of the policy was left for trial, but the judgment shows that the benefit of a life policy may not always pass to the survivor.
Myall v Tower Insurance [2017] NZHC 251	Rebuild to **"as when new"** standard	The insurer's primary obligation was to meet the cost of rebuilding the house "to the same condition and extent as when new". The Court held these words allow some tolerance from a requirement to build the house (in this case, a substantial historic homestead) to the exact specifications as when new. The rebuild must be equal, but not necessarily identical, to the original building.
Prattley v Vero [2016] NZSC 158, [2016] 19 ANZ Insurance Cases 62-121, [2017] NZCCLR 1	**Multiple earthquake events** **Contractual Mistakes Act**	The Supreme Court dismissed an appeal by Prattley challenging a "full and final" settlement agreement. The parties had correctly approached the calculation of the indemnity sum payable under the policy. Accordingly, there was no common

Case	Issues	Decision / Principle
		mistake as to the correct measure of indemnity and no entitlement to relief. Restatement of the "indemnity principle" for damage caused by successive earthquakes.
Quake Outcasts v Minister for CER [2016] NZSC 166	**Crown offer to purchase** uninsured and uninsurable properties	Application to appeal directly from High Court to Supreme Court dismissed. No basis to depart from usual hierarchy for appeals.
Robinson v IAG [2016] NZHC 3149	Claim by a **bankrupt** to sue on a policy	Application by bankrupt under s 119(2) of the Insolvency Act 2006 to vest a right to sue on an insurance policy, after that right had been disclaimed by the Official Assignee. Dismissed – unfair for right to vest in view of complex factual history, the insolvency of the prospective plaintiffs and the likelihood that the claim would fail.
Southern Response Unresolved Claims Group v Southern Response [2016] NZHC 3105	**Representative action**	Successful reformulated application for leave to bring a representative action on behalf of 41 insureds with residential earthquake claims (for original decision, click here). There was a defining common and central allegation that Southern Response had adopted a co-ordinated strategy to avoid its proper obligations to claimants. The judgment is being appealed. Group members may have been partially misled by statements on the website promoting the proceeding. An explanatory statement (to be approved by the Court) is to be provided, giving members a further "cooling off" period.
Tekoa Trust v Stewart [2016] NZDC 25578	**Intentional damage** by tenant to **residential property**	District Court declined to follow *Holler v Osaki* and held that damage caused to carpets from dog urine was intentional. The tenant (who was not allowed dogs) continued to have dogs in the house after initial incidents, when further damage was virtually certain. Insured damage cannot be recovered from a tenant unless it is intentional, an imprisonable offence, or unless insurance money is not recoverable due to the tenant's act or omission.
Trustees Executors Ltd v Fund Managers Canterbury Ltd [2016] NZHC 2194	Application of an **exclusion for professional services** in a **D&O policy**	A fund manager provided monthly certificates from its directors to the trustee of the fund. The certificates formed part of the fund manager's professional services to the trustee, and the D&O policy did not respond. The directors were entitled to cover under the fund manager's PI policy.
Witty v Rout [2016] NZHC 3016	Trustee's **duty to insure**	The insurance over a deceased's property was allowed to lapse, due to the oversight of the estate's solicitor and trustee, and the property was uninsured during the 2011 Canterbury earthquake sequence. The house was damaged and was sold for a reduced value. The solicitor, as trustee of the estate, had a duty to preserve trust property and secure it from risk. While this will not always translate into a duty to insure, there was sufficient cash in the estate to pay premium and it was

Case	Issues	Decision / Principle
		reasonable to insure in light of the September 2010 earthquake. The Court awarded damages of $205,000, being the loss suffered on the sale of the property, plus indemnity costs.
Young v Tower Insurance [2016] NZHC 2956	**Novel repair** methodology **Economics** of repair Contractual **duty of good faith**	Policy required any repair to use construction methods commonly in use at the date of loss. Tower's proposed repair methodology was novel and untried, and a rebuild was accordingly required. It was unclear whether repair was an economically viable option for a reasonable insurer. Tower breached its contractual duty of good faith by withholding an early report recommending a rebuild; nominal award of $5,000 in general damages.
Zurich v Withers [2016] NZCA 618	Professional Indemnity - accountants **Dishonesty exclusion**	Zurich was entitled to rely on a dishonesty exclusion to decline cover for liability under the Fair Trading Act 1986. The court was prepared to assess dishonesty on appeal because the material facts were not in dispute and there were no questions of credibility. Significant weight was placed on the insured's breach of professional accounting standards (which prohibited misleading and deceptive statements) when determining that he had been dishonest when breaching undertakings.

Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd [2016] NZSC 158

by Stephanie Corban and Rob McStay

The Supreme Court dismissed an appeal by Prattley which challenged a "full and final" settlement agreement between Prattley and Vero. The Court held that the parties had correctly approached the calculation of the indemnity sum payable under the policy. Accordingly, there was no common mistake between them as to the correct measure of indemnity.

Background

Prattley owned a building in the Christchurch CBD which was damaged in the earthquake of September 2010, and suffered further extensive damage in the Boxing Day earthquake. The building was 'red-stickered' by the Christchurch City Council and was no longer able to be occupied. The building sustained additional damage in February 2011 and was demolished (following a demolition order from CERA) in September 2011.

Prattley insured the building with cover on an indemnity basis. The policy stipulated an indemnity limit of $1,605,000. Prattley claimed on its insurance policy and valuations were obtained. The parties engaged in settlement discussions and agreed that Vero would pay Prattley $1,050,000 plus GST in full and final settlement of the claim.

Subsequently Prattley commenced proceedings challenging the settlement on the basis that the parties had entered into the agreement under a common mistake as to the correct measure of indemnity. Prattley sought to set aside the settlement agreement under the Contractual Mistakes Act 1977 (**CMA**) and sought judgment for the difference between its alleged entitlement and the amount it received. Prattley's claim was unsuccessful in the High Court and the Court of Appeal.

Re-opening the settlement agreement

The CMA can provide a mechanism for relief if the parties to a contract were influenced by a mistake of law or fact; and the mistake resulted in a substantially unequal exchange of values, or the conferment of a benefit or imposition or inclusion of an obligation which is substantially disproportionate to the consideration given. Under s 6(1)(c) relief is precluded where a term of the contract obliges the party seeking relief to assume the risk of its belief about the matter in question being mistaken.

In the Court of Appeal the primary question had been whether Prattley had assumed the risk of mistake so as to preclude relief under the CMA. However the Supreme Court determined that since it was satisfied there was no common mistake, it did not need to engage with s 6(1)(c). As a result, the Court did not rule on whether the terms of the settlement agreement precluded Prattley from relief under s 6(1)(c). The Court stated at [8]:

> "…if s 6(1)(c) is construed broadly, there would be little, and perhaps no scope for relief under the Contractual Mistakes Act, which would thus be at risk of becoming dead letter. This may suggest that some specificity as to, and not merely a general, assumption of risk may be necessary to engage s 6(1)(c). Working out how to resolve all of this may not be easy and we see it as a task best deferred until a case arises where such resolution is critical to the result."

The correct measure of indemnity

In reaching the view that there was no common mistake, the Supreme Court reviewed what the correct measure of indemnity under the policy should be. Prattley claimed it was entitled to be indemnified by way of repair or reinstatement of the building, up to the agreed limit on cover. By contrast, the settlement with Vero was based on assessments (in the alternative) of the market value and the depreciated replacement value of the building.

The Supreme Court concluded the parties had taken the correct approach to calculating indemnity in reaching their settlement, although the agreed value was inflated by an incorrect rental assessment (provided by Prattley). The Court stated: "the most obvious approach to the calculation of indemnity was the pre-event value of the land and building and demolition costs less the residual (that is post-

demolition) value of the land, so as to leave Prattley with land and money equating to the pre-event value of what it had before the earthquakes".

Since Prattley did not intend to rebuild the building, the Court observed it would be a clear breach of the indemnity principle if Prattley's argument was to succeed. Further, since the settlement resulted in Prattley receiving more than it would have been entitled to if the correct rental assessment had been used, the Supreme Court concluded that "[Prattley] had no legitimate grounds for complaint".

The Supreme Court cited and endorsed the Court of Appeal's general description of the "indemnity principle" in *Wild South*[1] which applies when buildings are damaged in successive earthquake events. The Court noted that the insuring clauses in the *Wild South* policies were "standard" clauses, that were very similar to the Prattley policy. Prattley's reliance on the Supreme Court's judgment in *Ridgecrest*[2] was misguided: *Ridgecrest* involved an unusual insurance arrangement and the judgment had no application to the present case.

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[1] *QBE Insurance (International) Ltd v Wild South Holdings Ltd* [2014] NZCA 447, [2015] 2 NZLR 24. For our summary of that judgment, click here.
[2] *Ridgecrest NZ Ltd v IAG New Zealand Ltd* [2014] NZSC 129, [2015] 1 NZLR 40. For our summary of that judgment, click here.

Zurich Australian Insurance Ltd v Withers [2016] NZCA 618

By Nick Gillies and Anna Parker

In this appeal Zurich was entitled to rely on a dishonesty exclusion to decline PI cover for an insured's liability under the Fair Trading Act 1986 (**FTA**). The insured, Mark Withers, was an accountant who had acted in breach of certain undertakings. In reaching this decision, the court placed significant weight on professional accounting standards when assessing whether Mr Withers had acted dishonestly.

As a result, the judgment sum of $1.31m against Zurich was set aside, and judgment was instead entered in favour of the plaintiffs against Mr Withers personally.

Background

The plaintiffs (the Swindles) loaned $3m to the Vintage Group (**Vintage**). The funds were intended as working capital for Vintage's wine business but were instead used to repay inter-company loans. Vintage only repaid $380,000 before being wound up, leaving the Swindles out of pocket for $2.62m. They therefore looked to Vintage's accountant, Mr Withers, to recover their loss.

It was a condition precedent of the loans that Mr Withers would be a mandatory signatory for Vintage's costs account, and that account would be used solely to meet production costs. Mr Withers gave undertakings to that effect. The Swindles' claim relied on those undertakings.

The High Court found Mr Withers liable for misleading and deceptive conduct under the FTA for failing to fulfil his undertakings. However, damages were reduced by 50% to $1.31m for contributory negligence.

Mr Withers looked to his PI insurer, Zurich, to cover his liability. In the High Court, Zurich's grounds for declining the claim, including reliance on a dishonesty exclusion, were rejected and judgment for $1.31m was entered against Zurich. Zurich appealed.

Dishonesty exclusions

The policy contained an automatic extension for liability under the FTA subject to a proviso that excluded cover for liability arising from dishonest, fraudulent, criminal, malicious or intentional conduct.

The policy also included a general dishonesty exclusion for liability "arising out of or connected with any actual or alleged dishonest … act or omission" or "with a reckless disregard for the consequences".

Zurich relied on this dishonesty proviso and exclusion.

Appeal decision

The court considered that it able to determine on appeal whether these exclusions applied because the "primary facts" were not in material dispute and no question of credibility arose.

The test for determining dishonesty incorporates objective and subjective elements. In summary, the relevant person is measured against an objective moral standard of what constitutes honest behaviour (the objective element), and they must also have acted with conscious impropriety (subjective element).

In this case, Mr Withers' explanation that he had misunderstood the undertakings, rather than being dishonest, was not accepted on appeal. Importantly, expert evidence of professional accounting standards and Mr Withers' failures to meet those standards was "of singular relevance" in establishing the objective measure of dishonesty. Particular reference was made to the NZICA Code of Ethics, including its Fundamental Principle of Integrity, which prohibits false or misleading statements. An experienced accountant in his position, having regard to his role and his professional ethical obligations, would have understood the serious adverse consequence if his undertakings were wrong.

That appears to have been the correct result in a case for breach of an undertaking. However, assessing dishonesty by reference to professional standards may be more difficult where the insured has breached other professional rules.

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Young v Tower Insurance Ltd [2016] NZHC 2956

by Christina Bryant and Richard Belcher

This judgment of Gendall J introduced a new principle of insurance law: the proposition that a mutual contractual duty of good faith is implied in every insurance contract and that damages may be awarded for a breach of that duty.

The plaintiffs (the trustees of the Young trust) owned a residential property in the Christchurch hills insured by Tower Insurance Ltd ("Tower"). The property suffered significant damage as result of the Canterbury earthquake sequence in 2010 and 2011 and claims were lodged accordingly.

The central issue for the Court to consider was whether the property could be repaired to the standard required under the insurance policy, or whether it needed to be rebuilt. However, the plaintiffs also alleged that Tower had failed to act in good faith, and sought general and exemplary damages.

Having noted that insurance is a contract of utmost good faith, and Tower's agreement to be bound by the Fair Insurance Code 2016, Gendall J held that a contractual duty of good faith is implied into every insurance contract, and is a duty that flows both ways.

While he declined to define the full scope and limits of the duty, the judge found that, as a bare minimum, the duty requires an insurer to:

1. Disclose all material information that the insurer knows or ought to have known. This duty includes, but is not limited to, the initial formation of the contract and arises during and after the lodgement of a claim.

2. Act reasonably, fairly and transparently. Again, the duty includes, but is not limited to, the initial formation of the contract, and arises during and after lodgement of a claim.

3. Process a claim in reasonable time. This obligation must take into account the time required properly to investigate and assess all aspects of the claim. What is "reasonable" will depend on the circumstances, which may include the type of insurance policy, the size and complexity of a claim, compliance with any relevant regulatory parameters, and factors outside the insurer's control.

Importantly, an insurer will not breach the implied term by failing to pay a claim during a dispute (provided there are reasonable grounds for that dispute). However, Gendall J noted that the conduct of the insurer in handling the claim will be relevant when deciding whether the duty of good faith has been breached.

The Judge held that Tower breached its duty by failing to provide an early report that recommended a rebuild of the house (despite that report being superseded by later assessments). The report had been provided to Tower's claims processing agent early in the claims process and was not passed on to Tower until later. The failure to provide the report made little difference to the outcome of events, and the plaintiff was awarded nominal (general) damages of $5,000. Exemplary damages were not available for a contractual breach, and, in any event, were not justified by the insurer's behaviour.

The Judge's ruling that a general contractual duty of good faith is implied in every insurance contract is a new development in New Zealand insurance law, and the parameters of that duty have yet to be defined. It is important to note that the duty is mutual. The plaintiffs' own conduct attracted criticism from the Judge and adversely affected some of their claims.

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