



The Right to Replacement: It's Personal

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By a 3:2 majority the Supreme Court has upheld the decisions of the High Court and Court of Appeal in *Xu v IAG New Zealand Ltd*,¹ on the non-assignability of replacement benefits in insurance contracts.²

Background

Mr and Mrs Barlow (**the Barlows**) owned a residential property in Christchurch that was damaged by the September 2010 and February 2011 earthquakes. The Barlows had a policy of insurance for accidental damage, underwritten by IAG New Zealand Ltd (**the policy**). The policy provided that:

The amounts you can claim

If, following loss or damage you

- (a) restore your Home, we will pay the cost of restoring it...*
- (b) do not restore your Home, we will pay the lesser of*
 - (i) the amount of the loss or damage, or*
 - (ii) estimated cost of restoring your Home...*

In the event of claim under the policy, the Barlows were entitled to elect between an indemnity payment (**indemnity**) or reinstatement (**replacement benefit**). The Barlows made a claim under the policy but sold the property before the claim was settled. The Barlows assigned their rights under the policy to the purchasers, Xu and Diamantina Ltd (**Xu**). At the time of assigning the insurance policy to Xu, the Barlows had not taken steps to reinstate the property (nor did they intend to).

The High Court and the Court of Appeal both held that Xu, as an assignee, was not entitled to a replacement benefit under the policy.

¹ *Xu v IAG New Zealand Ltd* [2017] NZHC 1964, (2017) 19 ANZ Insurance Cases 62-160; *Xu v IAG New Zealand Ltd* [2018] NZCA 149, 20 ANZ Insurance Cases 62-177.

² *Xu v IAG New Zealand Limited* [2019] NZSC 68.

Had the replacement benefit accrued?

The majority of the Supreme Court rejected Xu's argument that the replacement benefit under the policy accrued when the insured event occurred and instead upheld the rule in *Bryant*³ that a replacement benefit is conditional on steps taken by the insured to reinstate the property. By selling the property, the Barlows had avoided the financial costs of the repair work and had therefore not suffered a loss triggering the right to the replacement benefit.

Can the replacement benefit be assigned?

Xu's position before the Supreme Court was that under the law of assignment, an assignee is able to fulfil a condition upon which an assigned right depends *unless* it makes a difference to the counterparty whether the condition is fulfilled by the original party or the assignee. Xu argued that IAG was indifferent to whether an original insured or a subsequent purchaser reinstated the property.

IAG argued that this proposition is incorrect because the moral hazard to IAG increased if a party other than the original insured elected to reinstate the property as the value of the property may well increase after reinstatement. IAG could be faced with a situation where an opportunistic purchaser seeks to maximise its benefit and profit from a loss it did not itself suffer. Further, IAG submitted that this interpretation was in accordance with the policy definition of "*the insured*" and reference to "*you*" in the operative policy provision.

Majority: Young, O'Regan and France JJ

The majority agreed with IAG and held that in accordance with *Bryant*, the right to replacement was personal to the insured and could not be assigned.

Minority: Glazebrook and Arnold JJ

The minority dissented and agreed with Xu that the replacement benefit was assignable and that *Bryant* was wrongly decided.

- (a) The minority criticised the decision in *Bryant* on the basis that the Court of Appeal in that decision based its judgment on two decisions relating to indemnity rather than replacement insurance, and that the Court did not consider the general law on assignment.
- (b) The minority considered there was force in Xu's submissions that the position in *Bryant* could result in homeowners being forced to accept an indemnity payment because of the delays in claims handling.
- (c) In respect of the moral hazard to the insurer, the minority considered that unlike other types of insurance, there was nothing so obviously personal in the reinstatement condition that meant it could only be discharged by the Barlows as the original owners.

Role of Condition 2

Counsel for Xu submitted that *Bryant* could be distinguished from the present case as the wording of Condition 2 in the policy entitled the purchaser to the replacement benefit under the policy (provided Xu complied with the policy conditions). Condition 2 provides:

³ *Bryant v Primary Industries Insurance Co Ltd* [1990] 2 NZLR 142 (CA).

Insurance during sale and purchase

2. *Where a contract of sale and purchase of your Home has been entered into the purchaser shall be entitled to the benefit of this Section but to get this benefit the purchaser must*
 - (a) *comply with all the Conditions of the Policy, and*
 - (b) *claim under any other insurance that has been arranged before claiming under this Policy.*

This argument was rejected by all of the Supreme Court judges deciding the case who agreed that Condition 2 was intended to reflect the position under section 13 of the Insurance Law Reform Act 1985,⁴ the purpose of which was to provide protection to purchasers for loss suffered during the time period after a contract for sale and purchase had been entered into but prior to settlement.

Key points

The decision provides welcome certainty to insurers who are settling claims brought by assignees on the basis of indemnity value in reliance on the principle of non-assignability of personal rights established in *Bryant*.

The ramifications of the decision will be felt by purchasers of earthquake damaged properties who have been assigned rights under the previous owners' existing insurance claims. It is a timely reminder as to the importance of potential purchasers seeking legal advice on entitlements under assigned insurance claims and the meaning of policy provisions such as the entitlement to insurance during sale and purchase.

While the Supreme Court has confirmed the orthodox position in *Bryant*, the majority prefaced their decision with the caveat that the decision is specific to the policy wording the Court was asked to consider and there therefore remains a risk that other policy wordings may result in a different interpretation.

⁴ Insurance Law Reform Act 1985, s 13.