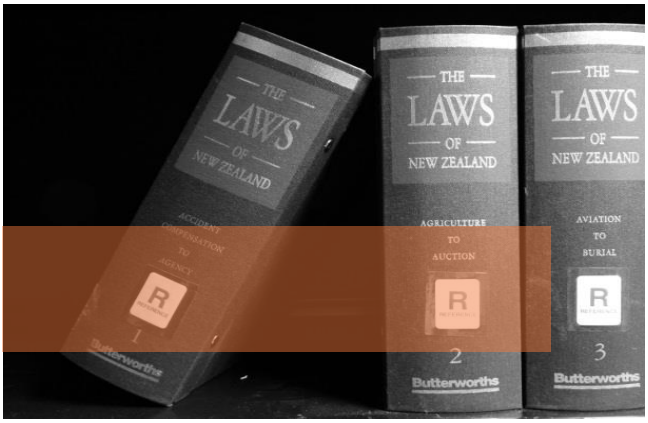

Insurance Case Law Update

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In this update, we summarise significant insurance decisions released in the latter part of 2014.

Litigation arising out of the Canterbury earthquakes continues its progress through the levels of appeal. The Supreme Court's judgment in *Ridgecrest* disposed of the doctrine of merger in the context of event-based policies, but identified the "indemnity principle" as a bar to the double counting of damage caused by successive earthquakes. The application of the indemnity principle was considered further by the Court of Appeal in *Wild South/Marriott/Crystal Imports* and by the High Court in *Morrison*.

The Supreme Court's judgment in *Firm PI 1 Ltd v Zurich* outlined the principles which apply to contract interpretation in New Zealand. Disappointingly, the Court did not resolve the controversial question of whether pre-contractual negotiations are able to be used for the interpretation of contracts. However, the judgment signals a more conservative approach to contract interpretation, in line with that taken in England and Australia.

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

Summary of cases:

Case	Issues	Decision / Principle
Ridgecrest v IAG NZ (SC)	Entitlement to recover **damage caused by successive earthquakes**	The doctrine of merger is inconsistent with an event-based policy, where liability is reset after each event. The indemnity principle caps claims at the replacement value and prevents claims for damage to the same elements of a building.
Firm PI 1 Ltd v Zurich New Zealand (SC)	Whether the sum insured was **inclusive or exclusive of EQC** cover **Contract interpretation**	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 and factual context as meaning the sum insured was inclusive of EQC cover.
University of Canterbury v ICNZ (SC)	Requirement to increase the **seismic strength** of buildings	A territorial authority cannot require a building to be strengthened to a seismic capacity of more than 34% NBS.
Skyward Aviation 2008 Ltd v Tower Insurance (SC)	Interpretation of Tower's **Provider House Policy**	The insured, not the insurer, has the right to elect to reinstate the property and to choose between options for reinstatement. If the insured elects to purchase a replacement property, he or she is not obliged to purchase a property which is comparable with the original property when new.

Case	Issues	Decision / Principle
Wild South v QBE Marriott v Vero Crystal Imports Ltd v Lloyd's (CA)	Entitlement to recover **damage caused by successive earthquakes** **Automatic reinstatement** of cover When a property is **destroyed** Application of **average**	Where damage occurs in successive earthquakes, recovery is limited to the repair of cumulative damage and any repairs undertaken before further damage occurred. Interpretation of automatic reinstatement clauses. Cover reinstates after each successive earthquake. Notice of cancellation can be given prospectively; cover and liability for premium remain in place until the notice date. Destruction depends on the facts of each case; whether repairs are physically feasible is not the only consideration. The measure of value when applying average is the elected measure of loss (indemnity value or reinstatement value, as the case may be).
Avonside Holdings Ltd v Southern Response (CA)	Assessment of **hypothetical costs** of rebuild	Right to acquire another property capped at the cost of rebuilding the insured property on the existing site. Hypothetical cost of rebuild should include contingencies and professional fees.
New Zealand Fire Service Commission v Insurance Brokers Association Of New Zealand Incorporated [2014] NZCA 179, [2014] 3 NZLR 541	Calculation of **fire service levies** under section 48, Fire Service Act 1975 on "split tier" and "multi insured composite" fire insurance policies	Levies based on "amount for which the property is insured" could be a reference to indemnity value or the sum insured. For "split tier" policies: 1. If settlement is upon a basis no more favourable to the insured than indemnity value, and specifies a sum insured lower than its indemnity value, the levy is to be computed on the sum insured. 2. If a policy provides cover for indemnity value and contains a capped sum insured, the levy is computed on the sum insured. If the sum insured exceeds the indemnity value of the property, the levy may be calculated on indemnity value. 3. If settlement is limited to value in excess of its indemnity value, no levy is payable on the excess. For multi insured composite policies, where separate parties insuring separately own property under a single contract of insurance, policy to be viewed as a single contract of insurance and only one levy is payable.
Islington Park Ltd v Ace Insurance Ltd [2014] NZCA 446, (2014) 18 ANZ Insurance Cases 62-038	**Contract interpretation**	Interpretation of the contractual measure for a deemed total loss. Specific to the policy in issue.
Bridgecorp Ltd (in rec & liq) v Lloyd's [2014] NZCA 571	**Extra territorial reach** of s 9 of the Law Reform Act 1936	Claim under s 9, Law Reform Act 1936, against London-based underwriters. Policy provided for governance by NZ law and exclusive jurisdiction of NZ Courts. However, debts payable under the policy would be located in England (underwriters' place of business). NZ Court lacked jurisdiction to make orders under s 9 requiring the underwriters to pay anyone other than the insured.

Case	Issues	Decision / Principle
Jensen v Rameka (HC)	**Exemplary damages**	First case of exemplary damages being awarded against a solicitor for professional negligence.
Morrison v Vero (HC)	Assessment of **damage in multiple earthquake events**	First application of indemnity principle to a substantive claim. Computer model applied to assess damage attributable to each event. Relief under s 9(1)(b) of the Insurance Law Reform Act for late notification of damage.
Earthquake Commission v ICNZ (HC)	Approval of EQC Policy for **Increased Flooding Vulnerabiity**	Increased Flooding Vulnerability and Increased Liquefaction Vulnerability constitute natural disaster damage under the EQC Act. The EQC's Policy is consistent with its statutory obligations. Claimants may challenge EQC decisions by judicial review or in ordinary proceedings.
Kraal v Earthquake Commission [2014] NZHC 919, [2014] 3 NZLR 42, 18 ANZ Insurance Cases 62-015	Whether **loss of a right to occupy** due to a risk of future damage is "physical loss or damage to the property"	"Red Zone" property owners unable to occupy home because of risk of rock falls and potential injury. Owners unsuccessfully sought declarations that loss of possession and use constituted "natural disaster damage" under the EQC Act and "damage" under a private insurance policy. Inability to occupy is a "loss of the ability to exercise a legal right… not 'physical loss…to the property'".
Marac Finance Ltd v Vero Liability [2014] NZHC 1974	**Quantification of loss** under Commercial Crime Policy	Endorsement did not alter the meaning of the operative clause of the policy, acted instead as an exclusion clause. Failure to comply with an arbitration clause will not result in indemnity costs if party has elected to submit to litigation.
Michalik v Earthquake Commission [2014] NZHC 2238	**Meaning of "indemnity value"** in Earthquake Commission Act 1993	Indemnity value of a 37 year old retaining wall under the EQC Act is its depreciated replacement value. Review of meaning of indemnity value under the EQC Act and at common law.
JCS Cost Management v QBE [2014] NZHC 2718	Policy responds to **claim made**, not conduct of insured	Policy provided cover for civil liability for conduct in connection with a professional business practice. The claim made against the insured was for conduct which did not fall within the scope of cover. The policy would not respond, even if the evidence proved that the insured's conduct was in fact connected to his professional business practice.
MacDonald v Tower Insurance [2014] NZHC 2876	**Admissibility of evidence**	Challenge to admissibility of briefs of evidence prior to trial. Examples of inadmissible evidence from litigation support agencies/funders and non-experts.

Ridgecrest New Zealand Ltd v IAG New Zealand Ltd
[2014] NZSC 129, (2014) 18 ANZ Insurance Cases 62-032

Ridgecrest is the first of a series of proceedings which addresses the vexed issue of incremental damage arising from multiple earthquake events.

Ridgecrest owned a commercial building damaged by earthquakes on 4 September 2010 and 26 December 2010. Limited repairs were undertaken after each earthquake, but all work ceased on 22 February 2011 when a further earthquake struck. There is an ongoing dispute as to whether the building was destroyed on 22 February, or by a later earthquake on 13 June 2011.

The building was insured under a full replacement policy, with a maximum liability for any one "happening" of $1,984,000. That sum was considerably less than the building's replacement value.

The parties asked the High Court to determine a preliminary question – is the plaintiff entitled to be paid for the damage resulting from each happening up to the limit of the sum insured in each case? The High Court's response was that the insurer's liability was limited to the cost of repairs actually undertaken and the maximum sum of $1,984,000 for the final destruction of the building. The Court of Appeal reached the same conclusion, but on different grounds.[1]

By contrast, the Supreme Court held that, on the specific wording of the policy, Ridgecrest was entitled to be paid for damage up to the limit of the sum insured for each of the earthquakes. The total claim could not exceed the actual replacement value of the building and there could be no "double counting" (multiple claims for the same damage).

Much of the argument focused on the doctrine of merger, which had been rejected by Dobson J in the High Court, but accepted by Cooper J in the *Crystal Imports* proceeding. IAG argued that Ridgecrest's claims for partial losses from the earlier earthquakes merged into the total loss suffered in the final earthquake. The Court reviewed the marine insurance cases in which the doctrine of merger arose. It identified material differences between IAG's policy and the marine insurance policies which meant that merger was inconsistent with the policy terms. They were:

1. The policy provided for both indemnity and replacement cover and therefore it was possible the insured could make a profit, in the sense it could recover on a replacement basis more than the actual (indemnity) value of the building.
2. The policy did not operate on the basis of a loss assessed at the end of the risk period, but on each happening.
3. IAG was liable to make a payment regardless of whether repairs were done.
4. A cause of action in respect of the losses caused by each earthquake accrued immediately.
5. The liability limit was reset after each happening.

The Court went on to consider the effect of the indemnity principle on Ridgecrest's claim. The principle states that an insured cannot recover more than its loss. Noting that "indemnity principle" is an awkward phrase in the context of a replacement policy, the Court accepted that it precluded recovery of more than the actual replacement value of the property (as distinct from the sum insured). It also prevented claims for incremental damage to the same elements of a building. While the Court noted that it is possible for parties to deem the sum insured to be the replacement value in their policy, it declined to take that approach in *Ridgecrest*, due to the policy wording and the presentation of the argument before the Court.

Ridgecrest may be the end of the road for the merger doctrine in the context of event-based liability policies. The scope and application of the indemnity principle will no doubt be the subject of further argument, depending on the facts of particular claims. The principle was reviewed by the Court of Appeal in *Wild South/Marriott/Crystal Imports* and by the High Court in *Morrison*, which are discussed elsewhere in this update.

Back to Summary Table

[1] Read our commentary on the Court of Appeal decision here

Firm PI 1 Ltd v Zurich Australian Insurance Ltd t/a Zurich New Zealand [2014] NZSC 147

This judgment resolved a preliminary question over the interpretation of a replacement policy for a residential apartment complex which was destroyed during the Canterbury earthquakes. The policy had a maximum limit (sum insured) of $12.95m, which was based on a pre-earthquake estimate of its replacement value. The actual replacement cost was $25m.

The dispute turned on clause MD15 of the standard 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 Insurer[']s liability will be limited to the amount of loss in excess of the Natural Disaster Damage cover.*** (our emphasis)

Zurich claimed that "loss in excess of Natural Disaster Damage cover" meant "insured loss", so that its liability was limited to the difference between the statutory cover provided by EQC and the sum insured (i.e. $12.95m less EQC cover of $6.8m). The insured claimed that "loss" meant "actual loss", so that the cover provided by EQC was deducted from the replacement cost of $25m, leaving Zurich liable for the full amount of the sum insured.

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

The High Court found that the broker 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 was fixed with that knowledge.

Both the High Court and Court of Appeal outlined the approach to contract interpretation set out in *Vector* and quoted Tipping J's statement that the ultimate objective in a contract interpretation dispute is to establish the meaning the parties intended their words to bear.[2] They differed in their view of the plain words of MD15. The Court of Appeal held it was apparent from the factual background that both parties intended cover to be limited to the difference between EQC cover and the sum insured.

The grant of the application for leave to appeal to the Supreme Court aroused some interest, as it promised to resolve a controversy as to whether, and to what extent, *Vector* allowed pre-contractual negotiations to be used as an aid to contract interpretation. The Court of Appeal has taken the view that such materials are admissible.[3] However, the Supreme Court has hinted in a number of judgments that it might take a contrary view if and when the opportunity presents.

Disappointingly, *Zurich* left this issue unresolved. The majority found the document with the premium calculation was in fact the original policy certificate (as opposed to negotiation materials). When the certificate and Brokernet wording were read together, it was clear that cover was limited to the difference between EQC cover and the sum insured. Although the subsequent policy certificate did not set out the basis for the calculation of premium, the Brokernet wording was interpreted consistently across the policies. The minority judges disagreed with the conclusion, but not the approach.

As a result, *Zurich* is largely confined to its facts. It is a further signal that the Supreme Court is taking a more conservative approach to contract interpretation, and is likely to use opportunities which present to bring New Zealand into line with the United Kingdom and Australia.[4] The Court made it clear in *Zurich* that the words of the contract are of central importance, and contextual interpretation may have little part to play if the parties know that third parties will rely on the words that have been used.

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[2] *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] 2 NZLR 444 at [19]
[3] *i-Health Ltd v iSoft NZ Ltd* [2012] 1 NZLR 379 (CA)
[4] See for example [60]-[63]. The Court preferred the English test for contract interpretation to the test outlined by Tipping J in *Vector* and quoted in the Courts below

University of Canterbury v Insurance Council of New Zealand Inc [2014] NZSC 193

The Supreme Court has upheld the Court of Appeal's interpretation of the statutory powers of territorial authorities to require that work be undertaken on buildings which are earthquake-prone.

Under s 122 of the Building Act 2004, 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 full bench of the Supreme Court confirmed that both criteria had to be met before a building was earthquake-prone. Only buildings with a capacity of less than 34% of the New Building Standard (NBS) are capable of being earthquake-prone.

The Court split 3: 2 on the question of whether a territorial authority could require an owner to undertake work on an earthquake-prone building which was necessary to remove the likelihood of collapse but which would take the capacity of the building above 34% NBS.

Section 124(2)(c) of the Act empowers a territorial authority to issue a notice requiring work to be carried out on an earthquake-prone building to "reduce or remove the danger". The minority held that "the danger" was the danger of collapse in a moderate earthquake. If the building's characteristics meant that the danger could only be reduced if the building was strengthened above 34% NBS, then the territorial authority was empowered under s 124(2)(c) to order that work be done. The majority, by contrast, took the view that the work required was limited to that necessary to ensure that the building was no longer earthquake-prone (i.e. that its capacity met 34% NBS).

The effect of this judgment 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 moderate earthquake.

As noted in our report on the Court of Appeal judgment (click here), these decisions highlight the tension between the imposition of a nation-wide standard and the desire for Councils to respond to regional circumstances and/or deal with specific characteristics which make a building vulnerable to collapse. The history of the Canterbury earthquakes makes it clear that buildings which meet 34% NBS may still have features which make them deadly when an earthquake strikes.

The Supreme Court's judgment is consistent with the current draft of the Building (Earthquake-prone Buildings) Amendment Bill, which leaves the benchmark of 34% NBS as "the standard at which a building is considered sufficiently safe to take it outside the scope of the power given to territorial authorities… to require strengthening work to be undertaken."[5]

Back to Summary Table

[5] Majority at [63]

QBE Insurance (International) Ltd v Wild South Holdings Ltd
Marriott v Vero Insurance New Zealand Ltd
Crystal Imports Ltd v Certain Underwriters at Lloyd's of London
[2014] NZCA 447, (2014) 18 ANZ Insurance Cases 62-037

The *Wild South*, *Marriott* and *Crystal Imports* proceedings involved commercial properties incrementally damaged in successive earthquake events.[6] The proceedings were heard together by the Court of Appeal in August 2014. The Supreme Court's *Ridgecrest*[7] decision was released shortly after the hearing, giving the Court of Appeal opportunity to consider the scope of the indemnity principle outlined in *Ridgecrest* before delivering its judgment.

Merger and the Indemnity Principle

All of the proceedings concerned the application of full replacement policies, in circumstances where the sum insured was less than actual replacement cost. Had the properties been destroyed in the first earthquake, the insureds would have had to cover the shortfall. The unusual sequence of the Canterbury earthquakes, where aftershocks were more destructive than the main event, created an opportunity for insureds to bridge the gap by claiming the cost of repairing damage caused by each earthquake. There was accordingly a risk of "double counting": claims for successive damage to an element of a building, which could be repaired at the end of the earthquake sequence for less than the aggregate of the claims.

Crystal Imports Ltd confirmed that this was, in fact, its objective. In the High Court, Cooper J had held that its claims for partial loss in the first earthquake(s) merged in its claim for total loss in subsequent earthquakes, so that only the latter loss could be claimed. This not only ruled out "double counting", it also capped liability at the sum insured per event (as loss could only be claimed for the final earthquake).

The Supreme Court's decision in *Ridgecrest* ruled out merger as a solution. However, the Supreme Court also held that the indemnity principle precludes the recovery of more than the replacement value of the property in cases where the insured property has been damaged, and then destroyed. Unless the policy deems the sum insured to be the replacement value, the indemnity principle will not prevent recovery above the sum insured to the level of the insured's actual loss.

The Court of Appeal confirmed that the policies before it were indemnity policies, notwithstanding the provision for reinstatement on a "new for old" basis. It clarified that the indemnity principle means that where damage to a building has not been remedied when a subsequent event occurs, the insured is only entitled to recover the cost of remedying the cumulative damage. If repairs have already taken place, the insured is also entitled to recover the cost of that expenditure. The amount recovered may exceed the sum insured, provided the loss from each event is less than the sum insured.

Operation of automatic reinstatement clauses

A central issue in the appeal was the operation of automatic reinstatement clauses. All of the policies provided for a reduction in the sum insured following an event by the amount of the loss caused by that event. They also provided for automatic reinstatement of the "amount of insurance cancelled by the loss", unless either party gave written notice to the contrary. Upon reinstatement, the insured was liable for additional premium.

The insured buildings suffered incremental damage during the Canterbury earthquake sequence, which began on 4 September 2010. Most were destroyed in the catastrophic aftershock on 22 February 2011 or in the earthquakes on 13 June 2011. Notice was not given to cancel reinstatement between the original earthquake and the aftershocks. The insurers argued that under the policies, cover only reduced or was cancelled when a payment was made on a claim. The insurer could accordingly give notice to prevent reinstatement of that cover at any time before payment was made.

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[6] For our commentary on the High Court proceedings, click here for *Wild South*, here for *Marriott* and here for *Crystal Imports*

[7] *Ridgecrest NZ Ltd v IAG New Zealand Ltd* [2014] NZSC 129, click here for our review of the decision

The Court of Appeal held that cover reinstated immediately following the insured event. The insured became liable to pay additional premium from that time. Either the insurer or the insured could give notice cancelling reinstatement going forward, but cover (and the liability to pay premium) remained in place for the period between reinstatement and the date of notice. As notice was not given before further events occurred, the insureds were fully covered for each earthquake.

When is a building destroyed?

In Marriott, a different measure of indemnity applied if the building was damaged, rather than destroyed. If it were damaged, the obligation was to restore it to an "as new" condition. If were destroyed, it could be rebuilt to its modern equivalent.

Dobson J in Marriott concluded that a building is only destroyed when repair is physically impracticable. The Court of Appeal concluded that Dobson J's answer was incorrect: a number of considerations may inform a trial judge's decision as to whether a property should be restored or replaced. The measure of the insured's loss may depend on his or her intentions for the property and reasons for owning it, as well as the policy terms. The economics and physical feasibility of the repair are both considerations. There is no uniform test: each case will depend on its own facts.

Subtraction of deductible

The Court set aside the High Court's determination that the deductible under the Vero and QBE policies was to be subtracted from the sum payable under the policy (as opposed to the actual loss). There was no evidence as to the meaning of "adjusted loss" in each policy, which would need to be resolved at trial.

Average

The Court confirmed that Cooper J's interpretation of the Average clause in the Crystal Imports policy was correct. Where average applies the insurer pays the same proportion of the loss as the sum insured bears to the value of the property. The measure of the value is that used to determine the amount of loss following the destruction of the property. If the insured elects to reinstate, the measure is the reinstatement value. If the insured elects not to reinstate, the measure is the indemnity value.

Comment

Both the *Ridgecrest* and *Wild South/Marriott/Crystal Imports* decisions raise questions as to how the indemnity principle will operate in practice. The Court's affirmation of the principle offers insurers some protection from multiple claims for the same losses.

The Lloyd's Underwriters applied for leave to appeal to the Supreme Court on the grounds that the Court of Appeal had wrongly interpreted the automatic reinstatement clause and wrongly applied the average clause. The application for leave was declined ([2014] NZSC 186).

Back to Summary Table

Avonside Holdings Ltd v Southern Response Earthquake Services Ltd [2014] NZCA 483; (2014) 18 ANZ Insurance Cases 62-040

This decision clarifies what an insured is entitled to receive when an election is made under a policy to acquire another property and the insurer is liable to pay no more than the cost of rebuilding the insured property on its present site. Unless the actual policy wording provides otherwise, rebuilding costs should allow for both contingencies and professional fees.

Background

The appellant, Avonside Holdings Ltd, owned a rental house that was insured with AMI. The property suffered damage in the 4 September 2010 and 22 February 2011 earthquakes and was damaged beyond economic repair. EQC paid out to its cap in relation to each event. The land on which the property was situated was red-zoned. Avonside sold the land to the Crown and retained its rights against Southern Response, which had assumed AMI's obligations under the policy.

As permitted by the policy, Avonside had elected to buy another house. The case concerned whether, and to what extent, an allowance for contingencies, the costs of professional fees and the cost of replacing external works should be included in the calculation of the cost of rebuilding the property.

Calculating the rebuilding costs

A hypothetical assessment of the rebuilding costs was required. Avonside disagreed with Southern Response that contingencies and professional fees should be excluded. Avonside also argued that its entitlement should be assessed on the basis of rebuilding each part of the property, including items that were repairable.

Evidence given on behalf of Southern Response distinguished between the cost derived for an actual rebuild and a notional rebuild. In a notional rebuild various costs would not be incurred, and therefore Southern Response reasoned that those sums should not be included in the sum calculated to be the cost of rebuilding the property. The Court considered that approach was wrong. It agreed with Avonside that the costs could not be excluded merely because the rebuild was not going to happen and the costs would not be incurred. The Court focused on the policy wording which provided the costs "must not be greater than rebuilding your rental house on its present site". The Court considered this phrase covered both the full replacement cost and additional costs, such as contingencies and professional fees. Justice Clifford, who delivered the judgment of the Court, noted that the phrase "the full replacement cost" was more limited than the wording used in the policy.

In relation to external works (such as fences, walls and the driveway) the Court found that there was nothing in the policy that precluded the reuse of any part of the house or its associated works that were not themselves damaged beyond repair. Accordingly, if an "as new" property could be produced by repairing or reinstating external works rather than rebuilding those items from new, the rebuild costs were to be calculated on the basis of the repair work being carried out.

Back to Summary Table

Jensen v Rameka [2014] NZHC 1720

In 2003 the law firm Jensen Waymouth assisted Mrs Rameka in making a Will. In November 2005, when Mrs Rameka was seriously ill in hospital, a second Will was prepared by the firm and Mrs Rameka's de facto partner attended to its execution. After Mrs Rameka died, probate was granted in respect of the second Will, but it was later declared to be invalid because Mrs Rameka's testamentary capacity had not been established. The invalidity of the second Will meant the prior, first Will, would have had effect, but Jensen Waymouth had destroyed the first Will and all records of the instructions from which it had been prepared. In 2011 a claim was brought against the firm by a beneficiary under the first Will for $30,000 in exemplary damages (compensatory damages were not sought).

In the District Court, the firm conceded it owed a duty of care to the plaintiff not to destroy the first Will which it had breached, but submitted the circumstances were such that exemplary damages were not appropriate. Although no case where exemplary damages had been awarded in a claim for legal professional negligence was identified by either counsel or the Court, the Judge awarded exemplary damages of $30,000. The firm appealed against the award of exemplary damages and the quantum.

The High Court, following the reasoning in *Couch v Attorney-General* [2010] 3 NZLR 149 (SC) and *Bottrill v A* [2003] 2 NZLR 721 (PC), considered the issue was whether the firm's actions met the test of subjective recklessness. It confirmed the lower Court's findings that the firm had a policy requiring express instructions before destroying a prior Will; no such prior instructions had been obtained; they were aware a prior Will could have effect if a subsequent Will was invalid; and it was "inconceivable" the firm was unaware of the potential prejudice in the event the first Will was destroyed. The Court upheld the award of exemplary damages.

The level of damages was reduced by the Court from $30,000 to $23,000, based on principles identified by the Court of Appeal (*McDermott v Wallace* [2005] 3 NZLR 661 (CA)), consistent with precedent. While awards of exemplary damages are relatively few in number and limited in quantum in New Zealand, they often fall in the $20,000 to $25,000 range, with the high watermark being around $100,000. Those at the higher end are typically sexual abuse cases.

The case is of interest insofar as it reinforces the conservative view the New Zealand courts take towards awards of exemplary damages. But perhaps more significantly the judgment makes it clear the door is open for exemplary damages claims against solicitors and other professionals for breach of professional duty.

Back to Summary Table

Morrison v Vero Insurance New Zealand Ltd [2014] NZHC 2344

This case grappled with the issue of how to apportion damage between multiple insured events – specifically the Canterbury earthquakes. The Court had to evaluate the efficacy of modelling in the absence of full direct evidence of the damage caused by each event.

Background

The plaintiff owned a commercial building that was indemnified by the defendant. The total sum insured was $3,482,000 per event, with cover reinstating at the end of each event. The object of an indemnity payment under the policy was to return the plaintiff to its position prior to the event of loss (ie on an old-for-old basis).

The plaintiff claimed there were five earthquake events causing loss – on 4 September and 26 December 2010 and on 22 February, 6 April and 13 June 2011. The plaintiff estimated the total amount payable for damage caused by these events at $13,100,000. In support of this the plaintiff employed modelling to identify the five events of loss and estimate the extent of damage from each. In simple terms, the model measured the ground shaking intensity of the specified earthquakes and their corresponding relative impact on the resilience of the building.

The defendant believed that only the September and February earthquakes caused damage, amounting to circa $3,985,000 applying the per event cap. It rejected the modelling as unreliable and contended that most, if not all, major elements were beyond repair after February 2011 so that subsequent damage was not material or claimable.

Modelling and the apportionment of damage

The Court acknowledged that modelling involves value judgments and, in this particular case, some of the defendant's criticisms had merit, including the inability of the model to incorporate the effects of liquefaction. However, these were not sufficient to render the plaintiff's model wholly unreliable. It was helpful for the purpose of understanding the relative impact of the earthquakes – as one input in the allocation of damage. In other words, the Court endorsed the use of modelling as a tool, but stressed that an overall judgment was still needed based on both the qualitative and quantitative evidence as to the likely apportionment of damage and repair across the events.

Here the Court did not accept that the December and April earthquakes were likely to have caused any damage or that the modelling estimate for the September earthquake was accurate. To this extent the model was rejected, but the scope of damage estimated by the plaintiff for the February and June events was generally accepted. The parties were invited to quantify the loss themselves based on these findings.

Material damage / constructive loss

The Court did not accept the defendant's argument that the building was effectively destroyed after the February earthquake, such that no additional sum is payable for further damage caused by the June earthquake.

Applying *Ridgecrest*[8], the Court acknowledged that an insurer cannot be required to pay more than the cost to replace a damaged item. However, on these particular facts, the June repair scope submitted by the plaintiff related only to items that were not included for replacement in the February earthquake. There was also evidence (including the modelling) that the June earthquake had caused material damage (any other conclusion was thought to be "highly improbable"). The Court also seems to have been influenced by the defendant's implied election not to give notice preventing the reinstatement of cover after the earlier and much more significant February event.

[8] *Ridgecrest NZ Ltd v IAG New Zealand Ltd* [2014] NZSC 129, click here for our review of the decision

Late notice

The plaintiff failed to inform the defendant of damage after the December, April and June earthquakes, despite the policy requiring immediate notification.

For the first two of these events, the absence of notice was irrelevant as the Court had already found that no material damage was caused, although s 9(1)(b) of the Insurance Law Reform Act 1977 would not have availed the plaintiff even if they had. That section provides that time limits on giving notice are only binding if the insurer was so prejudiced that it would be inequitable not to enforce the notice provision. Here the lack of notice for December and April deprived the defendant of an opportunity to inspect the damage or stop reinstatement.

By contrast, for the June earthquake, the Court was willing to apply s 9(1)(b). Unlike December and April, this was the last of the earthquakes on which a claim was based and the second largest in order of magnitude. As a result, it was not easily missed and there was an opportunity for the defendant to observe the state of the building afterwards (albeit some time later).

Expert witnesses

Somewhat unusually, the Court was critical of the caucusing between experts in that it was not as successful as it ought to have been. The Court stressed the need for actual and apparent independence of experts, early and meaningful discussions well in advance of trial, and constant professionalism (after one unfortunate incident).

Back to Summary Table

Earthquake Commission v Insurance Council of New Zealand [2014] NZHC 3138

Background

EQC sought a declaratory judgment from the High Court to approve its policy on "Increased Flooding Vulnerability" (the "Policy"), so persons insured under the Earthquake Commission Act 1993 (the "Act") have confidence that their settlements are based on adequate grounds.

Increased Flooding Vulnerability and Increased Liquefaction Vulnerability

EQC defines "Increased Flooding Vulnerability" as *"a physical change to residential land as a result of an earthquake which adversely affects the uses and amenities that could otherwise be associated with the land by increasing the vulnerability of that land to flooding events"*.

EQC's geotechnical evaluation of damage to residential land in the Christchurch area show that up to 13,500 residential properties are now more vulnerable to flooding from lower land levels as a result of the earthquakes.

The first issue that the Court had to resolve was whether "Increased Flooding Vulnerability" constitutes "natural disaster damage" to residential land for the purpose of the Act, and if so, how EQC may settle such claims.

"Natural disaster damage" is defined in section 2(1) of the Act and means any "physical loss or damage to the property occurring as the direct result of a natural disaster". "Physical loss or damage" is defined as any physical loss or damage to the property that is imminent as the direct result of a natural disaster that has occurred.[9]

The Court held that as a direct result of the earthquakes, there has been a reduction in the levels of the land, leaving the land more vulnerable to flooding. As the main use of residential land is a "platform for building", land that is more susceptible to flooding is clearly less fit for that purpose. Therefore a reduction in land levels satisfies the criteria for "physical loss or damage" as the damage is already present. The Court concluded that Increased Flooding Vulnerability constitutes "natural disaster damage" to insured residential land for the purpose of the Act, and made a declaration to that effect.

The Court also briefly looked at whether Increased Flooding Vulnerability constitutes natural disaster damage to "residential buildings" under the Act. It held that in cases where an earthquake caused reduction in levels of the land that resulted in a building sinking, but has not actually affected the physical state of the building, Increased Flooding Vulnerability does not constitute "physical loss or damage" to residential buildings.

Not only has residential land in Christchurch become more vulnerable to flooding as a result of the earthquakes, but it has also become more vulnerable to liquefaction from future earthquakes. In light of this, the Court held that for the same reasons, "Increased Liquefaction Vulnerability" constitutes "natural disaster damage" for the purposes of the Act.

The Court then considered how EQC will settle claims for Increased Flooding Vulnerability. The Court held that the declaration sought by EQC to settle land claims by providing a payment based on repair or reinstatement cost or on a "diminution of value" basis where appropriate, were consistent with its obligations under the Act to insure on an indemnity basis.

Anticipatory Relief

A second key issue that the Court sought to resolve was whether and in what circumstances the High Court is entitled to grant anticipatory relief to an insured person, either by judicial review or by declaratory judgment under the Declaratory Judgments Act 1908.

[9] Section 2, Earthquake Commission Act 1993

Is judicial review available?

The Court considered whether an insured person can bring an action for judicial review against EQC in relation to the Policy. Under section 4(1) of the Judicature Amendments Act 1972, an application for judicial review can be made to the High Court "in relation to the… proposed… exercise by any person of a statutory power" to seek relief by way of declaration against that person in any such proceeding. The Court confirmed that EQC was a public body against which relief could be obtained by judicial review.

Relief under the Declaratory Judgments Act 1908

The Court looked at the circumstances in which anticipatory relief could be granted by way of a declaratory judgment under the Declaratory Judgments Act 1908. That act "enables anyone whose conduct or rights depend on the effect or meaning of an instrument… to obtain an authoritative ruling…Access to the jurisdiction does not depend on there being an existing dispute".[10]

The Court analysed past cast law on point and concluded that the High Court may provide anticipatory relief on questions of statutory interpretation if "an appropriate evidential foundation were available to enable a legal question to be determined". It follows that in this case, there was a sufficient factual foundation on which appropriate declarations could be granted.

The Court then turned to the legitimacy of EQC's Policy. The Court accepted that it was appropriate for EQC to formulate and apply the Policy to manage claims for statutory entitlements, however the Policy must not operate as a substitute for a statutory framework. Further, it must not be applied too mechanically, but rather be applied on a case by case basis.

The Court concluded that EQC was entitled to implement guidelines in relation to Increased Flooding Vulnerability provided EQC acted in good faith and provided that the guidelines are not applied mechanically, do not exclude consideration of factors relevant to any particular case and do not prevent claimants challenging the decision in a court by way of ordinary proceeding or judicial review.

The right to bring ordinary proceedings to enforce EQC's statutory obligations

EQC sought a declaration that an insured person can only enforce an obligation owed by EQC by bringing an action of judicial review in the High Court. Therefore the issue before the Court was whether there was also an ordinary right of action available to an insured person against EQC concerning an unresolved insurance claim.

The Court held that the Act is a "scheme of statutory insurance", however, this does not stop it being enforced by way of ordinary proceedings. EQC's statutory obligations to make right/make payment under the Act create rights in an insured person and those rights create obligations, enforceable by ordinary action.

Further, there is no express exclusion of an ordinary right of action in the Act and in many cases, judicial review will not be an appropriate mechanism to determine entitlement to payment under a statute, for example, where the obligation is of a definite nature. Therefore, the Court declined to make the declaration sought by EQC.

Back to Summary Table

[10] *Mandic v Cornwall Park Trust Board* [2011] NZSC 135