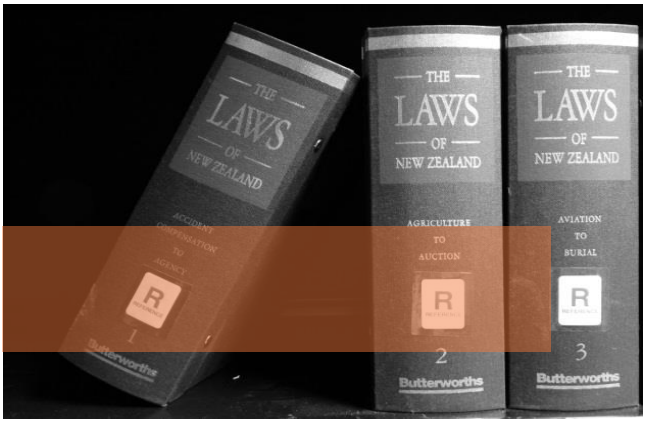

Insurance Case Law Update

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In this insurance law update, we summarise significant decisions released in the second half of 2015.

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
Southern Response v Avonside Holdings Ltd [2015] NZSC 110	Assessment of **notional costs** of rebuild	Right to acquire another property capped at the cost of rebuilding the insured property on the existing site. Notional cost of rebuild includes an estimate for contingencies and professional fees.
Carter Holt Harvey Ltd v Minister of Education (CA)	**Product liability**	Refusal to strike out claims in tort and under the Consumer Guarantees Act against a manufacturer of building products by the end-consumer. Building Act 10 year limitation longstop does not apply to product manufacture and supply. Leave granted to appeal to Supreme Court.
Tower Insurance Ltd v Domenico Trustee Ltd (CA)	Insurer's right of **election**	Finding of election by delay not available on the pleadings, judgment set aside and proceeding remitted to High Court. Reservation expressed as to whether Court can itself make an election for an insurer by reason of delay.
JCS Cost Management Ltd v QBE (CA)	Interpretation of a **professional indemnity** policy	Policy required a causal nexus between the claim made and the professional services. Definition of services did not include free advice given to a client to secure prospective work.
Vero Liability Insurance Ltd v Heartland Bank Ltd (formerly Marac Finance Ltd) [2015] NZCA 288 and [2015] NZSC 168	**Commercial Crime Policy**	Policy covered direct financial losses consequent on act(s) of dishonesty by an employee with a clear intent to cause loss to the insured. Appeal allowed: no clear intent to cause loss to Marac. Loans were made dishonestly but in the belief that continued trading by the debtor would lead to repayment of all that was owed. No direct losses during the policy period: advances made were less than repayments. Supreme Court declined leave to appeal.
HHR Christchurch NTL	Interpretation of a	Tenant requested an insurance certificate to

Case	Issues	Decision / Principle
Ltd v Crystal Imports Ltd [2015] NZCA 283	**composite material damage** policy **Estoppel**	confirm that the landlord's interest was covered by the tenant's material damage policy. Insurer provided the requested certificate. Dispute as to whether the policy covered the landlord's interest. Tenant and insurer estopped from denying cover.
AAI Ltd v 92 Lichfield Ltd (in rec & liq) [2015] NZCA 559	Use of **statutory demand** procedure **Contract interpretation**	AAI applied to set aside a statutory demand based on a debt allegedly owed under a settlement agreement. Substantial dispute as to terms of the agreement (based on the factual matrix) and whether an agreement had been concluded. The statutory demand was an abuse of process, as the debt was known to be subject to a genuine dispute.
Northern Farm Services Ltd v Codylan Farms Ltd [2015] NZCA 567	Test for breach of **professional services** contract	Performance is measured by common professional or industry practice, provided that practice can withstand logical scrutiny on an assessment of relative risks and benefits.
Parkin v Vero Insurance New Zealand Ltd (HC)	Repair to standard **"when new"** Breach of **Fair Insurance Code**	If an element has only a functional purpose, a repair which restores function to a "when new" condition is sufficient. "Jacking and packing" concealed foundations met this repair standard. Alleged failure to explain policy entitlements not pleaded or made out on the facts.
C&S Kelly Properties Ltd v EQC (HC)	EQC right of **election** Exercise of **discretionary rights**	EQC's statutory right of election is equivalent to a contractual right. EQC's right to elect to reinstate was lost through delay. Insured given option of either a cash settlement or reinstatement.
Miah v National Mutual Life [2015] NZHC 993	Ownership of **life insurance** policy	Life insurance policy jointly owned by husband and wife. Wife died following bankruptcy of husband. Official Assignee refused to assign policy on his release from bankruptcy. Husband sued insurer as executor of his wife's estate. Held: the benefit of the policy is owned solely by the surviving spouse, whose rights had vested in the Official Assignee.
Southland Indoor Leisure Centre Charitable Trust v Invercargill CC [2015] NZHC 1983	**Duty of care** owed by councils for defects in commercial buildings Councils' ability to **limit liability** in contract **GST** payable in **subrogated claims**	The Trust successfully sued the Council for the Stadium Southland roof collapse. The action was a subrogated claim, and the amount recovered by the Trust and paid to the insurer would be subject to GST. The Trust sought to recover GST on top of damages from the Council. Held: 1) a damages award is not a taxable supply 2) as the Trust is GST-registered, its loss is limited to the net cost of repairs and lost rent 3) a damages award is not a payment under the insurance contract (the Trust's right to damages is independent of that contract). The payment from the Trust to the insurer is received in a different context, which justifies a different tax treatment. Subrogated recoveries are a source of revenue in the insurer's business.
Banicevich v AMP Services (NZ) Ltd [2015] NZHC 2273	Avoidance of policy for **breach of utmost good faith**, disclosure and fair dealing	Insurance agent took out trauma cover to generate commission income while in financial difficulty and did not intend to pay premiums on the due date. Policy avoided as a result. Policy also validly

Case	Issues	Decision / Principle
		cancelled and did not cover claimant's disease.
Newbery v AA Insurance Ltd [2015] NZHC 2457	**Contract interpretation**	Contents policy restricted cover for works of art, including ornaments and sculptures, not specified in the policy schedule. Reasonable contracting parties would understand "ornaments" (but not "sculptures") to include Lladro figurines.
Walters Law v AIG Insurance New Zealand Ltd [2015] NZHC 2701	Requirements for **advance notification**	Firm acted for Blue Chip and investors on a number of property settlements. In anticipation of a change to its professional indemnity insurance, the firm made an advance notification of all Blue Chip transactions. Insufficient information in notice to establish a substantial link between notification and claim made; summary judgment declined.

Liability for defective building products: *Carter Holt Harvey Ltd v Minister of Education & Ors* [2015] NZCA 321

Last year the High Court refused to strike out a claim that a designer, manufacturer and supplier of building materials owed a duty of care in tort to the ultimate property owner.[1] That decision has been upheld on appeal – paving the way for the possibility that, even in a commercial context, such a duty may exist. The claim will be considered next year by the Supreme Court, and may ultimately result in increased exposure to liability for product designers, manufacturers, suppliers and their insurers.

Background

Carter Holt Harvey ("CHH") produced a cladding system that was used in schools throughout the country, which the Minister of Education and others allege is defective and contributing to weathertightness problems. More than 600 schools are said to be affected.

Five causes of action were pleaded against CHH: (1) negligence, (2) negligent misstatement, (3) negligent failure to warn, (4) breach of the Consumer Guarantees Act 1993 and (5) breach of the Fair Trading Act 1986. CHH applied to strike out the first four on the basis they could not succeed and the 10 year limitation long-stop in s393 of the Building Act 2004 applied.

As this was a strike out application, the court was only required to consider whether the claims could not succeed and, in particular, whether it was possible there was a duty of care in tort. It did not involve a positive finding that such a duty actually existed, although the effect of the decision is to raise the likelihood of one being found.

Negligence – duty of care?

Ever since *Donoghue v Stevenson*,[2] manufacturers have generally owed a duty to end users to take reasonable care, which coincided with the rise in mass produced products and consumerism. Nevertheless, the existence of a duty in each case is still ultimately based on an assessment of foreseeability, proximity and any applicable policy considerations. Historically, a clear contractual chain, particularly in a commercial context, was believed to obviate a claim in tort.

In this case, the Court of Appeal ("Court") was in no doubt that a manufacturer in CHH's position would foresee that a defective cladding system could lead to weathertightness issues and potential loss. However, proximity was a more difficult question given the contractual chain in which the parties could allocate risk. The Court rejected CHH's argument that the contractual matrix was determinative and distinguished the present case from *Rolls-Royce* where there was no duty of care.[3] In *Rolls-Royce* the parties negotiated specific contractual arrangements directly, whereas here the chain of contracts was more diffuse and decentralised. The Court also observed that the Supreme Court in *Sunset Terraces* had noted with approval statements to the effect that a manufacturer of goods could be liable to a party with whom the manufacturer has no contractual relationship.

The absence of any specific duties on suppliers in the Building Act 2004 was not considered decisive. Nor was the Court persuaded by arguments about a lack of "vulnerability" premised on the basis the plaintiffs could have contracted for other parties to assume the risk of building defects.[4] The defects were latent and identifiable only by expert opinion, and even if the plaintiffs had been able to negotiate quality warranties from its contractors, this did not necessarily rule out a duty of care.

As for policy factors, the Court recognised that a duty of care to the plaintiffs could cut across the law of contract and undermine commercial certainty. However, these were regarded as matters requiring analysis at a full hearing (rather than a strike out application). As for what might be expected at trial,

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[1] [2014] NZHC 681
[2] [1932] AC 562
[3] *Rolls-Royce New Zealand Ltd v Carter Holt Harvey Ltd* [2005] 1 NZLR 324 (CA)
[4] This effectively distinguished the "vulnerability" approach adopted by the High Court of Australia, which the Court of Appeal said has not found favour in New Zealand.

the Court added that it was "satisfied" New Zealand tort law had developed independently of other common law jurisdictions.

Finally, the nature of the loss (ie replacing the defective cladding system and remedying the harm it has caused) did not preclude a duty of care. Traditionally, a tortious duty only arose when a defect in a product caused harm to other property or persons. This was based on the notion that repairing the defective chattel itself was "economic loss" and therefore not recoverable. However, the Court observed that, in recent times, New Zealand has rejected a clear distinction between economic loss and physical damage in terms of recoverability and thus a duty of care. This would potentially allow a plaintiff to recover not only the costs of repairs to damaged parts of the building resulting from the defective goods but also the costs of repairing or replacing the damaged goods.

In summary, there were a number of factors pointing against a duty of care (eg the supply of building components by commercial parties subject to no duties under the Building Act with the capacity and opportunity to negotiate commercial terms). Nevertheless, foreseeability and proximity were probably made out and policy factors were equivocal without detailed analysis. This was enough to refuse to strike out the negligence claims.

Misstatement

CHH did succeed in having the negligent misstatement cause of action struck out. The plaintiffs' contention relied on representations by CHH that could be said to have been causative of the loss. Statements about the cladding system were not made to any particular class of persons or for any specific building or project. Instead, they were made to consumers at large and were too general for there to be any basis for negligent misstatement

Breach of Consumer Guarantees Act

CHH's reliance on the "whole building" exclusion in the Consumer Guarantees Act was not accepted. There seems to be little doubt that CHH sold a cladding system (goods) which constituted supply of components for a building (not the building itself). In any event, this was ultimately a question that could only be answered at trial.

Limitation

The Court was satisfied that claims against CHH were not subject to the longstop limitation period under s393 of the Building Act 2004 since the manufacture and supply of the cladding system did not constitute "building works". The Court acknowledged this may see manufacturers/suppliers treated differently from building practitioners (who may have the benefit of that longstop) in a way that could be considered unjust and arbitrary. Nevertheless, it was the statutory intent under the Building Act and any unfairness was ultimately a matter for Parliament.

Summary

The Court confirmed the possibility that a manufacturer/supplier of building materials – even in a commercial context and where there is a chain of contracts – may owe a duty of care to the end user. If such a duty was found to exist it would likely further extend the law of negligence in New Zealand, in contrast to other common law countries. It also has the potential to expose manufacturers/suppliers to liability for leaky buildings where previously they may have thought they were immune. The Supreme Court has granted leave for an appeal, which is likely to be heard in 2016.

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Rights of Election: *Domenico Trustee Ltd* and *C&S Kelly Properties Ltd*

Summary

In our June 2015 summary, we discussed the High Court judgment of *Domenico Trustee Ltd v Tower Insurance Ltd*, which held that a right to choose the method for settling an insurance claim must be exercised within a reasonable time. Delay could result in the right being lost, with the election being made by the Court instead.[5]

Domenico was followed by *C&S Kelly Properties Ltd*, which applied the same principles to EQC's statutory right of election under the Earthquake Commission Act 1993. Shortly afterwards, *Domenico* was overturned on a pleading point and ordered for re-trial. While the Court of Appeal expressed reservations as to the substance of the High Court judgment, it did not give a final view. That is unfortunate, as the issue of delayed election features in a number of earthquake claims.

C&S Kelly Properties Ltd v Earthquake Commission [2015] NZHC 1690

The plaintiff owned a property which had been damaged in both the 4 September 2010 and 22 February 2011 earthquakes. The house was capable of repair, but a dispute arose as to whether the floors were out-of-level due to earthquake damage or pre-earthquake settlement. If re-levelling was not required, the total cost of repairs was $53,768.50. The Court held that the floors had suffered earthquake damage, but was unable to quantify the cost of re-leveling on the evidence before it.

EQC had a right under the Earthquake Commission Act to elect whether to reinstate the property or to make a payment. In September 2014, it made an unequivocal election to reinstate. EQC claimed that its exercise of this right of election could not be challenged, other than by judicial review.

Justice Mander held that the plaintiff could challenge the election in ordinary proceedings, as if EQC had a contractual – rather than a statutory – right of election. However, the test for challenging a contractual election is high. Judicial intervention is only appropriate if there is an implied term constraining exercise of the right, or if the right is exercised in bad faith, for an improper purpose, or arbitrarily, capriciously or unreasonably in the *Wednesbury* sense. An election to reinstate might, for example, be irrational if the cost of repair would clearly exceed the statutory cap.

The plaintiff's evidence did not meet the required threshold for a successful challenge. However, Mander J held that EQC's delay in making its election to reinstate meant that it lost its right to do so. There was no "default" option for settlement under the Earthquake Commission Act, so the choice between payment and reinstatement fell to be determined by the Court.

The means by which an election should be made in these circumstances is not clear from the judgment. The authorities cited by the judge propose different solutions for dealing with an insurer's failure to make a timely election. These solutions include:

(a) the right to elect is shifted from the insurer to the insured; or

(b) the Court makes the election for the insurer, by considering what the insurer would do, acting rationally, not arbitrarily or capriciously; or

(c) the Court makes the election based on the Court's own view of what is reasonable; or

(d) the Court orders the insurer to make the election (specific performance).

The judgment states that the election is to be made by the Court. However, the relief ordered by the Court was a right for the plaintiff to choose between a cash settlement ($53,768.50 plus the cost of re-leveling) or holding EQC to its election to reinstate.

The outcome may have been a pragmatic solution, and the judge made it clear that he viewed the latter option as the better outcome for the plaintiff. It is however difficult to understand the legal basis on

[5] [2015] NZHC 981. For our summary of the High Court decision, click here

which EQC could be bound by the attempted exercise of a right it no longer had, or how a statutory power of election could be transferred from the insurer to the insured.

Tower Insurance Ltd v Domenico Trustee Ltd [2015] NZCA 372

One month later, the Court of Appeal overturned *Domenico*. It noted briefly the similar views expressed by Gendall J in *Domenico* and by Mander J in *C&S Kelly Properties Ltd*.

Domenico involved a residential property insured by Tower, which had been damaged beyond economic repair. Under the terms of the policy, Tower could elect to satisfy a claim for the property's full replacement value by reinstatement or by a cash payment. If Tower elected to make a cash payment, the insured could elect to rebuild on the existing site, rebuild on another site, or buy another house. If the insured elected to rebuild, Tower had no obligation to make a payment until rebuilding costs were incurred by the insured.

Tower did not make an election between reinstatement and a cash payment. Instead, it engaged in protracted negotiations with Domenico for a non-contractual alternative solution, namely a cash settlement based on the cost of a rebuild before those costs were incurred.

Domenico claimed that Tower's conduct was consistent with an election to pay the full replacement value, and payment was in any event the "default" position under the policy if no election was made. The Court of Appeal disagreed: there was no election by Tower and no "default" position. Under the terms of the policy, the full replacement value was only payable once an election had been made and reinstatement costs incurred.

In the High Court, the plaintiff successfully argued that Tower lost its right of election as a result of delay. This argument was made only in closing, and was not heralded in the pleadings or dealt with by evidence or in argument. The Court of Appeal held that Tower was seriously prejudiced as a result and allowed the appeal on that basis. The matter was remitted to the High Court for a rehearing.

As a result, the Court of Appeal did not give a final view on Gendall J's proposition that if a right of election is not exercised within a reasonable time, the Court will itself make the election. However, the Court of Appeal expressed reservations as to whether the authorities relied upon by the judge supported that proposition. It noted that if the insurer's words or conduct were consistent with only one choice, a Court might on orthodox principles reach the conclusion that an election had been made. Alternatively, the Court could order the insurer to make an election (specific performance) or award damages in favour of the insured.

Comment

A right of election gives one party the power to choose between different contractual pathways. Once the electing party gives notice of its choice, the election binds everyone and cannot be undone. Notice can be express, but it can also be given by conduct. If steps are taken down one contractual pathway, the Court will infer that the election has been made. If a party delays a choice to diverge from a "default" contractual pathway (e.g. a choice to exercise a right of early termination), that delay may be interpreted as an election not to take the divergent option. In those circumstances, the law may be said to have made the choice for the party.

The proposition that a Court has power actively to exercise the choice for a party, in circumstances where there is no "default" pathway and election cannot be inferred, is an extension to orthodox contract law principles. The Court does not have a general power at law to vary contracts.[6] The primary remedy for a failure to perform a contract is damages. The Court may order a party to perform the contract (specific performance) if damages are not adequate, but the Court does not perform the contract itself.

It remains to be seen whether this new judicial power is endorsed and upheld in other judgments.
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[6] It may do so where rectification is necessary to reflect the parties' mutual intention, of where a statutory power to vary applies (e.g. Fair Trading Act 1986 s43(3)(c), Illegal Contracts Act 1970 s7)

JCS Cost Management Ltd v QBE Insurance (International) Ltd [2015] NZCA 524

This was an appeal from a summary judgment[7] dismissing a claim for civil liability cover under a professional indemnity policy on the basis the claim made against the insured was not in connection with his professional business practice. It highlights the need for insureds to consider carefully the nature of the services they provide, and whether their policy covers all of their business activities.

Background

The proceeding arose out of litigation concerning the purchase of a leaky home.[8] Mr Johnston, a director of JCS, a quantity surveying and project management company, attended an open home with a client in the hope of securing future project management work. The client had indicated that if she purchased the property, she intended to carry out significant renovations.

Following the purchase, the client retained JCS and began the renovations. Weathertightness issues were identified. The client and her husband sued Auckland Council, which joined Mr Johnston as a third party. The Council alleged that the purchasers bought the house in reliance on pre-purchase advice given by Mr Johnston as a "building appraiser". The Council's claim failed on the facts.

Mr Johnston incurred costs defending the Council's claim which exceeded the costs award. He brought a claim against QBE to recover the difference in costs under his professional indemnity insurance policy, plus compensation for damage to JCS's business and general damages. QBE rejected the claim and sought summary judgment, on the basis that the Council's claim was not connected to JCS's project management business. The High Court found in favour of QBE.

Cover under the insurance policy

The insurance policy included two significant clauses:

> QBE shall indemnify the Insured for any Valid Claim subject to the terms of this Policy.
>
> In addition, QBE shall pay Costs and Expenses incurred with the written consent of QBE in the defence or settlement of any Valid Claim, up to the Limit of Indemnity or $1M, whichever is the lesser.

Both of the clauses contain the term *"Valid Claim"*, defined as a claim *"alleging Civil Liability* ***by*** *any act, error, omission or conduct … in connection with the Insured's Professional Business Practice"*. *"Professional Business Practice"* was defined as the Insured's business of quantity surveyor and project manager. *"Project Manager"* was further defined as *"the provision of consultancy, certification or project coordination services for construction or development of projects where… those services are rendered for remuneration and the services fall within the insured's Professional Business Practice"*.

Mr Johnston was only entitled to defence costs under the policy if the claim made by the Council would – if successful – be a "Valid Claim". It was accepted that Mr Johnson attended the open home in connection with his business. However the majority of the Court held that a Valid Claim required a causal connection between Mr Johnston's notional liability for the pre-purchase advice ("the act, error, omission or conduct") and the Professional Business Practice covered by the policy. "Professional Business Practice" was narrowly defined: it only covered consultancy services for construction or development projects where the services were rendered for remuneration. Free advice given during a marketing exercise for a prospective project did not fall within this definition.

The majority accordingly held that the Council's claim against Mr Johnston was not a Valid Claim and dismissed the appeal against summary judgment. The minority judge, Miller J, took the view that the word "by" could encompass a meaning wider than a direct causal link, and would have left the interpretation of the policy to be determined at trial.

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[7] *QBE Insurance (International) Ltd v Wild South Holdings Ltd* [2014] NZHC 2718
[8] *Johnson v Auckland Council* [2013] NZHC 165; *Johnson v Auckland Council* [2013] NZCA 662.

Parkin v Vero Insurance New Zealand Ltd [2015] NZHC 1675

This decision will be welcomed by insurers. It provides judicial confirmation that "jacking and packing" can be an acceptable method of re-levelling and repairing floors that have suffered differential settlement.

Background

Mr Parkin's townhouse, which had been constructed in early 2009, was damaged by the September 2010 and February 2011 earthquakes. The property was initially in the "white zone", but this was eventually replaced with a green zone classification.

Mr Parkin's insurer, Vero, concluded it was economic to repair his house, and proposed doing so by jacking and packing the piles to remedy floor dislevelment.

Mr Parkin was unhappy with Vero's proposal and considered the house should be re-built. He contended that Vero was obliged to return the house to essentially an identical condition to what it was prior to the earthquakes, bearing in mind the house was less than two years old at the time of the first earthquake. He also sought payment of the estimated reinstatement costs before these costs were actually incurred, and alleged that Vero was in breach of implied terms of good faith and the Fair Insurance Code (**Code**) in relation to its claims handling process. These claims were rejected by the High Court.

Standard of repair

This was a "when new" type policy. Vero had the option to pay either (1) the cost incurred in "repairing the damaged portion … to a standard or specification no more extensive, nor better than its condition when new" or (2) the indemnity value if the house was not repaired or rebuilt by Mr Parkin within 12 months, unless Vero agreed to extend this period.

Mander J observed that "when new" suggests a narrower or stricter basis for comparison than "as new", which conveys a broader sense of comparison. Notwithstanding this, His Honour rejected Mr Parkin's "identical replica" argument (ie that all damage must be replaced like-for-like). If that argument was correct, it would render superfluous the concept of repair, which the policy expressly included and clearly contemplated.

Mander J drew a distinction between structural or functional components and those which have aesthetic purpose. Where an item has only a functional purpose, so long as the remedial strategy restores that functional purpose to a "when new" condition, the policy obligation will be met. That condition may be achieved by repair rather than replacement.

In this case, the fact that the house was reasonably new and did not previously have packers between the piles and bearers was of no consequence. The purpose of a pile and the foundation system as a whole is substantially, if not entirely, structural. Packers would not affect the structural integrity of the floor and they would not be visible except during a sub-floor inspection, meaning there was little or no aesthetic value attached to their use.

Payment obligation

Following the Court of Appeal in *Medical Assurance Society v East* [2015] NZCA 250, Mander J confirmed that Mr Parkin must actually incur the costs of remediating his property before Vero's obligation to pay the reinstatement sum is triggered. Absent Vero opting to pay the indemnity value, Mr Parkin had no entitlement to an advance cash payment based on the estimated cost of repair.

Breach of good faith/Fair Insurance Code

Mr Parkin also made what might be considered novel arguments regarding good faith and the Code. He claimed Vero was in breach of these alleged implied obligations by failing to explain his policy entitlements or how the policy was intended to operate, and that Vero did not manage the claim in

accordance with his policy entitlements, but applied its own internal management procedure, which did not follow the policy terms. Much of this was based around an alleged misapprehension by Mr Parkin that Vero would undertake the reinstatement.

Mander J did not directly address the question of whether these terms were implied into the insurance contract. Instead, His Honour was not satisfied there had been a breach of any such term, whether implied or otherwise. In particular, Vero had introduced a claims management process to handle the large wave of earthquake claims, and there was no evidence that Vero had acted unfairly or had been unresponsive. It appears that Mr Parkin's real frustration lay with Vero's assessment that his house could be repaired and the resulting impact on the claims settlement process when he disagreed with that assessment. However, as note above, Vero's repair strategy was upheld by the Court.

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