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NEW ZEALAND'S INSURANCE MARKET MAGAZINE

MARCH 2020 / ISSUE 19

COVER TO COVER

WELCOME

TO OUR FIRST ISSUE FOR 2020

Welcome to the 19th issue of Cover to Cover, our magazine for New Zealand insurance professionals

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2020 began with immediate challenges for the insurance industry, with devastating bushfires across the Tasman and the emergence and global spread of COVID-19, which at the time of writing had just reached New Zealand. The threat that these events pose to life and health is naturally the most pressing concern. However, they also have significant economic consequences and resulting impacts upon insurers.

In our first edition of *Cover to Cover* for 2020, we look at the impact of these events and the issues they raise for the insurance community. We also provide a regulatory update on the Government's review of insurance contract law and the Financial Markets (Conduct of Institutions) Amendment Bill (CoFI). CoFI has been introduced in an effort to improve the conduct and culture of financial institutions, leading to good customer outcomes. It will capture both insurers and brokers, who should keep an eye on its progress through Parliament (see *2020 Dates for the Diary* below for more information).

We also cover the Court of Appeal's decision in the "Right2Drive" litigation, which deals with at-fault drivers' liability for replacement car hire costs incurred by the not-at-fault party, in circumstances where the not-at-fault driver would not in fact be charged.

Finally, we look at the latest earthquake insurance cases from the High Court and the Canterbury Earthquakes Insurance Tribunal. These include cases on time limitations, an important case about insurers' liability for defective repair work and two decisions on policy interpretation issues.

It will no doubt be another busy year for the industry. Below are some key dates to be aware of.

2020 Dates for the diary

26 March	Public submissions close on the Financial Markets (Conduct of Institutions) Amendment Bill and the Financial Markets Infrastructure Bill
27 March	Public submissions close on the Fair Trading Amendment Bill
29 June	Financial Services Legislation Amendment Act 2019 comes into effect
23 July	Women in Insurance Summit (Hilton, Auckland)
29-31 August	Banking and Financial Services Law Association Conference (Millennium Hotel, Queenstown)
16-18 September	New Zealand Insurance Law Association Conference (Rydges, Queenstown)
10 November	Insurance Council of New Zealand Conference (Cordis, Auckland)

Managing risks in an ever-changing world

"Uncertainty is the only certainty there is, and knowing how to live with insecurity is the only security." – **John Allen Paulos, American Professor.**

The need to manage risks in an ever-changing world is not new. The insurance market has seen sea changes in approach over the last few decades, driven by the emergence of new risks and lessons from significant events.

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Significant underwriting changes are occuring, as insurers and insureds become more sophisticated in presenting and assessing risks. The Wellington property market and the D&O market are two recent instances of insurers' attitudes shifting rapidly, followed by brokers and insureds responding with more focused and detailed underwriting submissions directed at more granular risk assessment.

New year – new issues

In this article we focus on two issues that have assumed prominence since our last edition of *Cover to Cover*. First, we have seen countries across the world gripped by COVID-19, the Coronavirus disease. Secondly, parts of Australia have suffered some of the earliest and fiercest bushfires in history, likely linked to climate change.

COVID-19 – Coronavirus: trade, travel and insurance

The impact of the coronavirus has been devastating in some parts of the world and as this issue of *Cover to Cover* goes to print, the damage is spreading. Governments in China and around the world have responded, sometimes with extreme measures, to contain the spread of the virus. In New Zealand, the Government has temporarily banned entry into New Zealand by foreign travellers who leave from, or transit through, China. Several businesses have issued profit downgrades owing to global disruption. Air New Zealand has cancelled all fights to and from China and, at the time of writing, Korea. Reduced international freight capacity is affecting exports of logs and other products. Some events at the Auckland Arts Festival are being cancelled because the necessary equipment cannot be freighted to New Zealand in time.

The threat to life and wellbeing is the most pressing concern. However, global economic disruption has also become a key concern given the increasingly integrated nature of global supply chains and the frequency of global travel. The effect on New Zealand is particularly strong, given that China is our largest trading partner.

We expect many New Zealand companies with suppliers or customers in China to be adversely affected by the response to the coronavirus. These companies will be looking to their contractual and insurance positions in terms of events outside their control - as will travellers.

Business interruption insurance cover?

Many supply chain-dependant companies will have contractual protections in place to reduce or avoid liability to pay for goods and components that are not able to be delivered due to transit restrictions and geographic lockdowns. They may also be relieved from liability arising from a failure to meet their own supply obligations. However, even if a company can escape a contractual obligation by relying on a force majeure clause, in many cases this will not fully restore the company to the position it would have been in absent COVID-19.

For example, a New Zealand manufacturer which relies upon imported Chinese components might avoid liability to pay for those parts and be prevented from pursuing the supplier for non-performance. But its

"Where there is no physical loss or damage, the prospects of a traditional business interruption claim succeeding are likely to be remote."

inability to manufacture an end product may cause loss far beyond the cost of the relevant inputs, including lost profits, due to an interruption in the supplier's business.

In such cases, businesses should look closely at their insurance policies, particularly business interruption cover. However, difficult issues can arise. In particular, most policies require an identifiable instance of "physical damage" in order to trigger interruption cover. Policies often contain exclusions for disease-related losses. As broker Aon noted in a recent alert: "Property and Coronavirus (COVID-19): Is My Business Covered?":[1]

The trigger for any property insurance policy and resulting time element coverage is physical damage to insured property by an insured peril. Insurers are likely to argue that the introduction of a virus does not constitute direct physical loss or damage to insured property nor is it a covered peril. While the introduction of COVID-19 to insured property may be considered a fortuitous (unforeseen) event, similar to other triggers that are typically covered under property policies, it is most likely not covered due to standard policy exclusions. Insurers may point to exclusions related to loss or damage arising from delay, loss of market, loss of use or indirect or remote loss or damage. Alternatively, a policy may contain a contamination exclusion which embeds virus, disease or illness causing agent in the definition of contaminant. Most property policies, including ISO, specific insurer forms and most manuscript policies, do not cover a loss resulting from a virus.

Where there is no physical loss or damage, the prospects of a traditional business interruption claim succeeding are likely to be remote. Some policies may, however, contain sub-limits or endorsements for disease-related losses, although these appear rare.

Travel

COVID-19 has also been a focus for the travel insurance market. Many insurers were willing to meet claims arising from travel that was booked before the impact of the virus was known. However, most travel policies will no longer respond following the World Health Organisation's announcement that COVID-19 is a Public Health Emergency of International Concern, meaning that the disease is no longer an unexpected event. It pays to check when travel was booked and what was known at the time.

Bushfires, climate change and risk

Closer to home, the 2019/2020 Australian bushfires have brought a renewed focus on the impacts of climate change, with many drawing a link between the two.

Fortunately, loss of life and property damage was not as severe as in past events, notwithstanding the large geographic areas affected.

However, insurers are focused more and more on climate-change related risk, including fire, flood and storm risk, in determining the extent and terms upon which they are prepared to write property and related covers. As well they should be, with Marsh Australia commenting that:[2]

Environmental threats dominate the top five long term risks by likelihood and occupy three of the top five spots by impact in this year's Global Risk Report produced by the World Economic Forum, in conjunction with Marsh and McLennan Companies and Zurich Insurance Group. This report further identifies that failure of climate change mitigation and adaption is the number one risk by impact and number two by likelihood over the next 10 years. Environmental insurance products can play a key part in mitigation against environmental risks.

Climate change also presents increased risks for companies and their directors and officers. We touched on the issue in our November 2019 edition of *Cover to Cover*. It remains a top priority with the Australian bushfires and their link to climate change, providing yet another reminder to directors of the seriousness of the issue and the risk to businesses which do not take action. Directors should consider their risk profile in respect of the risk of climate change liability.

We expect to see the insurance markets react as the number of climate change-related claims increase, both in New Zealand and abroad.

1. www.aon.com/getmedia/02abe458-ae63-4393-98d7-e2bce4f8cb39/Property-And-Coronavirus-Coverage-Considerations-COVID.asp
2. www.marsh.com/au/insights/risk-in-context/environmental-liability-insurance.html

Regulatory update, including the Conduct of Financial Investigations Bill

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In this article we examine current regulation and proposed changes affecting insurers and brokers.

Conduct of Financial Institutions Bill

The Government has made it clear that ensuring that financial institutions' "conduct and culture" result in good outcomes for all customers is a priority, following reports reports from the Financial Markets Authority and the Reserve Bank of New Zealand on conduct failures in the financial sector.

To that end, it has introduced the Financial Markets (Conduct of Institutions) Amendment Bill (CoFI) which received its first reading in February 2019.

The COFI Bill proposes a new regime for specified registered banks, licensed insurers and licensed non-bank deposit takers ("specified financial institutions"). The proposed regime will apply broadly to all services and associated products provided by specified financial institutions and, to varying extents, to other financial businesses and intermediaries which deal with or represent specified financial institutions. As insurers and brokers will be captured by this new regime, they should keep a close eye on its progress through Parliament.

Key elements of the proposed regime

If passed, the COFI Bill will amend the Financial Markets Conduct Act 2013 to ensure that specified financial institutions and their intermediaries comply with a principle of "fair conduct" and associated duties and regulations. The COFI Bill proposes the following:

- **Specified financial institutions that are in the business of providing relevant services must obtain a licence from the FMA under Part 6 of the FMC Act.** *'Relevant services' are defined as acting as an insurer (in relation to a consumer insurance contract, or other life or health insurance), being a creditor under a consumer credit contract, providing other retail financial services (of the kind that require registration as a financial services provider), or acting as a paid intermediary to a consumer for any of those activities.*
- **Specified financial institutions and intermediaries must comply with a fair conduct principle to treat consumers fairly, including by paying due regard to their interests in specific circumstances.** *The specific circumstances are when a financial institution: (a) designs any relevant service or any associated product; (b) offers to provide any of those services or products to a consumer; (c) provides any of those services or products to a consumer; or (d) has any dealing or interactions with a consumer in connection with any of those services or products). The fair conduct principle also applies when an intermediary is involved in the provision of any relevant service or any associated product to a consumer.*
- **Specified financial institutions must establish, implement, and maintain an effective fair conduct programme which meets the minimum requirements set out in the FMC Act.** *This requires operationalising the fair conduct principle through policies, processes, systems, and controls throughout every relevant part of their business, from the governance level to day-to-day interactions with consumers, whether those interactions are made directly or indirectly through intermediaries.*
- **Specified financial institutions and their intermediaries must comply with the fair conduct programme, and specified financial institutions must ensure the intermediaries comply.** *This is aimed at ensuring that the chain of distribution of services and products is captured and so institutions take responsibility from the top down.*
- **Specified financial institutions and intermediaries must comply with any regulations that regulate incentives based on volume or value sales targets.** *The possible regulations may*

apply to incentive arrangements entered into before the COFI Bill or its regulations have been enacted.

- **An insurance contract may be brought outside the scope of this new regime if a policyholder certifies in writing before entering into the contract that they are entering into the contract wholly or predominantly for business purposes.**

The COFI Bill is at Select Committee stage, which aims to report back by 23 June 2020. Entities that may be affected can make submissions on the proposed bill up until 26 March 2020.

Insurance contract law review

The Government has also been reviewing insurance contract law to ensure that it facilitates insurance markets that work well and enable individuals and businesses to protect themselves against risk effectively. An issues paper and an options paper were released in mid-2019 seeking public comment on the proposed policy decisions.

In December 2019, MBIE proactively released a paper and minutes of the Cabinet Economic Development Committee indicating what the Government intended to reform. In summary, the Committee has agreed:

- to change policyholders' duty to disclose material information so that:
    - consumers must simply take reasonable care not to make a misrepresentation
    - while non-consumers are required to make a fair presentation of risk
- to change the remedies for non-disclosure and misrepresentation for both consumers and non-consumers to provide proportionate consequences based on how the insurer would have reacted to the information at application time, and whether the policyholders intended to mislead or deceive the insurer or were reckless;
- to require insurers to inform policyholders of the duty of disclosure and its consequences before they enter the contract;
- that if an insurer seeks permission to access a consumer's medical or other third party records, the insurer must inform consumers of the types of third party information they are likely to access and when this is likely to happen, which the FMA will be responsible for monitoring and enforcing compliance;
- to remove insurance-specific exemptions from the unfair contract terms provisions in the Fair Trading Act 1986 and clarify how the generic exemptions apply to insurance.[1] The FMA will share responsibility with the Commerce Commission for enforcing unfair contract terms in relation to contracts for financial services or in relation to financial advice products;
- to require consumer insurance policies to be presented and worded clearly to help with consumer understanding; and
- that the duty of utmost good faith be codified in legislation and will apply to both parties in an insurance contract;
- to introduce a legislative requirement for intermediaries to pass onto the insurer all known material information – so that the insurer can recover losses against the intermediary if the intermediary fails to pass on information;
- that certain policy exclusions will not be subject to section 11 of the Insurance Law Reform Act 1977 (which provides that if a policy exclusion applies in relation to a claim but the exclusion did not cause or contribute to the loss, then the insurer must accept a claim);
- to replace section 9 of the Law Reform Act 1936 (which allows a third party wronged by a policyholder to place a statutory charge on the policyholder's insurance proceeds in certain cases) with a provision that allows third parties to claim directly against the insurer;
- to amend section 9 of the Insurance Law Reform Act 1977 to provide that an insurer under certain types of liability policies can decline a claim if the policyholder notifies the insurer after a defined period after the end of a policy term.

We are expecting the release of an exposure draft bill, which may be supplemented by new regulations, for consultation in 2020.

Regulation of financial advice

The new financial advice regime introduced by the Financial Services Legislation Amendment Act 2019 will come into effect on 29 June 2020 on which date all new obligations, aside from transitional requirements around competency, will come into effect. Anyone providing financial advice to retail clients from 29 June 2020 onwards will need to hold a transitional licence and comply with all obligations. For those solely providing financial advice to wholesale clients, there is no licensing obligation but there may be other obligations that apply.

The regulations supporting this regime are intended to be formally released in the coming months, with likely transitional provisions for disclosure requirements. We understand that the custody and broking requirements will continue in substantially the same form under the new regime with minor amendments.

The Code of Professional Conduct for Advice Services was finalised in 2019 but may have further guidance released to aid in applying the requirements.

Additional policy updates

The Reserve Bank suspended active work on the review of the Insurance (Prudential Supervision) Act 2010 in April 2018 following a careful prioritisation exercise. It is intended that this work will resume in due course. Over the course of the review the RBNZ intends to undertake further consultation to identify policy concerns and develop proposals to address these concerns effectively.

1. Further consultation is expected on options to clarify how generic exemptions of unfair contract terms apply to insurance.

GST payable on insurance proceeds received by third party claimants

Inland Revenue has confirmed that a third party claimant who is GST-registered can be liable for GST where they receive a payment from an insurer in settlement of an insured person's liability.[1] This applies irrespective of the third party claimant not being party to the insurance contract, and can apply where the settlement payment is for damages or loss incurred that would otherwise not ordinarily attract GST.

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The issue

Ordinarily there is no GST payable on a damages award, being compensatory in nature and with no reciprocity of supply. This is unless the damages are paid in respect of something that was itself a taxable supply, e.g. if a dispute is about non-payment for goods or services purchased. The act of settling a dispute is not, in and of itself, a taxable supply.

However, there has been some confusion about the GST treatment of a settlement payment that is funded by an insurance policy and paid directly by the insurer to the third party claimant. In its recent statement, Inland Revenue expressed its concern that some taxpayers are adopting the view that such settlement payments made directly to a third party claimant are not subject to GST.

Inland Revenue cites section 5(13) of the Goods and Services Tax Act 1985, which provides that *"if a registered person receives a payment under a contract of insurance, whether or not the person is a party to the contract, the payment is, to the extent that it relates to a loss incurred in the course or furtherance of the registered person's taxable activity, deemed to be consideration received for a supply of services performed by the registered person."*

This means that, even where a settlement is for compensatory damages, a third party claimant receiving an insurer-funded settlement payment is deemed to have made a taxable supply under section 5(13) and is liable for GST on the insurance proceeds. This is provided that the claimant is GST-registered and receives the payment in relation to a loss incurred in the course of its taxable activity, and the premiums under insurance contract were subject to GST (i.e. which is not usually the case where a non-resident is the insurer).

The following example illustrates how section 5(13) operates in practice:

- an insured person and an insurer have entered into a contract of insurance;
- a third party has agreed to settle a claim brought against the insured person in consideration for $1,000,000;
- the insurer pays the $1,000,000 agreed settlement amount directly to the third party claimant;
- the third party must pay GST of $130,435 on the sum received, and retains a net sum of only $869,565; and
- the insurer will be entitled to an input tax credit of $130,435.

Our view

Inland Revenue has advised taxpayers that, because there has been no change in the Commissioner's practice, it will continue to apply this treatment in all cases, including retrospectively.

We agree that Inland Revenue's position correctly states the intended effect of clause 5(13), and is consistent with the view that has broadly been adopted by GST experts. However, while Inland Revenue stresses that this reflects its long-standing position, in our experience the GST obligation imposed on third party claimants comes as a surprise to some and is difficult to apply.

In practice, a third party claimant will often not appreciate that it will be liable for GST on the insurance proceeds, or even be aware that the settlement payment will be funded by an insurer (thereby triggering a GST liability) and can risk leaving it undercompensated in settlement of its claim. This is especially harsh given that the claimant would also need to know whether GST was charged on the premiums under a contact of insurance to which it was not a party.

Inland Revenue's statement reinforces that failing to address GST during settlement negotiations can mean that a claimant will be out of pocket, receiving less than what was expected.

Future impact of Inland Revenue's GST issues paper

On 24 February, Inland Revenue released an issues paper seeking feedback on a wide range of GST-related policy matters, which included discussion on potential options for mitigating this GST issue.[2]

The first (and most disruptive) option proposed by Inland Revenue is to make insurers responsible for the GST obligations. This could be achieved through a reverse charge mechanism, or by denying the insurer's input tax deductions for insurance payments to a GST-registered person (the latter would mean that section 5(13) of the GST Act would consequentially be repealed).

Two alternative options being considered are:

- requiring insurers to disclose in writing to the third party that the amount of their settlement payment is covered by insurance and may be subject to GST; and
- retaining the current rules but providing education and guidance for advisors and GST-registered businesses.

Inland Revenue is inviting submissions on the potential compliance costs and system impacts of these three policy options.

If you would like assistance in making a submission to Inland Revenue, please contact a MinterEllisonRuddWatts tax advisor.

1. Commissioner's Statement CS 20/01: GST liability for insurance and settlement payments to third party claimants (CS 20/01) (https://www.classic.ird.govt.nz/resources/b/d/bde20259-0272-4c5d-86ef-bc9d84bc1996/cs-20-01.pdf)
2. https://taxpolicy.ird.govt.nz/publications/2020-ip-gst-issues/overview

Key case for motor vehicle insurers

Late last year, the Court of Appeal issued its decision in the "*Right2Drive*" litigation – three leading cases dealing with at-fault drivers' liability for replacement car hire costs incurred by the not-at-fault party.

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In these cases, not-at-fault drivers hired replacement vehicles from Right2Drive (New Zealand) Limited (R2D). While the rental agreement provided for a hire fee, R2D advertised on the basis that not-at-fault drivers would not, in fact, be charged a fee. R2D then sought to recover the hire fees from the at-fault drivers' insurers. The insurers resisted payment on the basis that the hire fees were not a recoverable loss because the not-at-fault drivers would never in fact be required to pay them.

The Court of Appeal upheld the High Court's decision, finding that at-fault drivers are liable for these hire costs, including delivery and collection fees, notwithstanding that the not-at-fault drivers may not in reality be required to pay them.

Companies like R2D have been the subject of much litigation in the United Kingdom and Australia, as they are perceived to be more expensive than traditional hire companies. However, the Court of Appeal in this case sent a clear message to insurers, warning against taking technical points. The Court commented that this litigation:

> *... does not reflect well on the motor vehicle insurers who are the real appellants. These insurers are certainly entitled to hold R2D to hiring a vehicle broadly similar to that damaged, and at a reasonable market rate. But, instead of being seemingly intent on knocking R2D out of business, it is to be hoped that New Zealand's motor vehicle insurers will now accept that R2D is providing a service that should be available to not-at-fault drivers because it minimises inconvenience to them.*

The at-fault drivers' insurers have sought leave to appeal to the Supreme Court. As at 31 January 2020, the Supreme Court was yet to decide whether to grant leave to appeal. However, motor vehicle insurers should consider the implications of this judgment, not only in the way they handle claims, but also in their underlying business models.

Facts

While this decision relates to three cases, the Court restricted its summary of the facts to those relevant to Mr Blumberg, the first-named respondent.

Mr Blumberg's car was damaged in a collision with a vehicle driven by an employee of Frucor Beverages Limited. Frucor's insurer sent Mr Blumberg to Barrys Point Panelbeaters & Painters to have the damage repaired. The repair was initially estimated to take two to three weeks. However, it took 33 days in total, due to the need for additional replacement parts and delays in ordering the parts.

When Mr Blumberg took his car in to be repaired, the panel beater told him that a courtesy car was not available and referred him to R2D. R2D advised Mr Blumberg that it would provide a replacement vehicle free of charge. Mr Blumberg signed a rental agreement, which said that R2D would use its best endeavours to recover the hire charges from the at-fault driver or its insurer, but "after expiry of the credit period R2D may demand that the hirer pay,and if so demanded this hirer shall pay forthwith, any charges unrecovered" from the at-fault driver or its insurer. The rental agreement also gave R2D authority to act on his behalf (Hire Agreement).

After the hire period ended, R2D prepared an invoice addressed to Mr Blumberg for hire charges of $3,782.46 (plus GST), together with a delivery and collection fee. When Frucor's insurer refused to pay the invoice, R2D issued proceedings against Frucor in Mr Blumberg's name.

The High Court found that Mr Blumberg and the other not-at-fault drivers were entitled to claim R2D's hire costs as special damages i.e. costs incurred in mitigating the loss arising from deprivation of their vehicles, providing that:

a) they acted reasonably in hiring a replacement car; and

b) the hire charges were reasonable.

The fact that liability for these charges would not have been enforced against Mr Blumberg did not affect their recoverability.

Court of Appeal decision

In finding for R2D, the Court of Appeal upheld the High Court decision, finding that:

- **The Hire Agreement was not 'champertous':** Frucor's insurer asserted that R2D's ability to sue in Mr Blumberg's name amounted to an improper assignment of a bare cause of action, barred by the tort of champerty. However, the Court of Appeal found that R2D had a genuine commercial interest in Mr Blumberg recovering the charges from Frucor and was entitled to sue in his name. This was not a case where R2D had taken assignment of a bare cause of action in which it had no commercial interest.
- **The correct test for determining reasonableness is an objective assessment of what a prudent driver would do:** The Court of Appeal found that Mr Blumberg did not act unreasonably by hiring a car from R2D simply because it was convenient: *"Having damaged Mr Blumberg's car and having put him to the inconvenience of having to arrange for its replace and for a replacement vehicle during the repair period, Frucor cannot be heard to criticise Mr Blumberg for taking the most convenient option available to him."* It was relevant that the panel beater could not offer a courtesy car, he was unsure of the length of time he would require one so traditional rental companies were not convenient, Frucor's insurer did not offer to provide Mr Blumberg with a replacement car and nor did it promote such a service on its website.
- **The 2015 Mitsubishi ASX hire car was a comparable vehicle:** The Court of Appeal found that *"…the replacement need be no more than in the same broad range of quality and nature as the damaged car"*. In this case the 2015 Mitsubishi ASX was a comparable vehicle to Mr Blumberg's 2005 Nissan Wingroad. In making an assessment *"one must not be hypnotised by any supposed need to find an exact spot rate for an almost exactly comparable car…"*
- **Delay in repair works was not an intervening cause disentitling Mr Blumberg from recovering the charges:** Frucor argued that delays caused by the panel beater's carelessness in not ordering replacement parts in a timely fashion disentitled Mr Blumberg from recovering charges for the period of that delay. The Court rejected this, nothing that *"it is foreseeable that there may be delays when vehicles are given to a repairer due to either the need to obtain parts, due to heavy workloads for repairers or insurance assessors having competing priorities".*
- **Interest was payable for non-payment of R2D's invoice:** Under Mr Blumberg's rental agreement, R2D was entitled to interest on charges that remained unpaid after the 90-day credit period ended. Frucor's insurer should have paid R2D's invoice to Mr Blumberg when it received it. Had it done so, R2D would not have been out of its money. If interest was not awarded Frucor's insurer would have received a windfall and R2D would have suffered hardship.

Case updates: The Canterbury Earthquakes Insurance Tribunal and Earthquake List

In this article we provide an update on some of the recent earthquake insurance decisions that have come out of the High Court and the Canterbury Earthquakes Insurance Tribunal.

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***Inicio Ltd v Tower Insurance Ltd*:[1] High Court issues decision on limitation periods**

In its first Earthquake List decision on limitations defences, the High Court has held that an insurer's offer to settle a claim amounted to an acknowledgment of liability under section 47 of the Limitation Act 2010, giving the policyholder a *"fresh claim"* and effectively re-starting the limitations clock.

In this case, the policyholder insured its house with Tower, for its full replacement value. The house was damaged beyond repair in the earthquakes. Tower assessed the full replacement value of the house at $321,797, and contributed that sum towards the building of two new units on the same property under a construction contract dated 18 September 2012. The policyholder was not required to sign a full and final settlement agreement.

The policyholder then wrote to Tower some five years later, in August 2017, claiming that Tower had undervalued its insurance claim.

Tower responded in February 2018, offering a further $55,030 to settle the policyholder's claim. In its letter, Tower advised that *"Based on the legal advice we have received, this represents the extent of Tower's outstanding liability with your claim."* It also noted that the offer included a professional fees allowance that Tower considered the policyholder was not entitled to.

Tower extended the time for accepting its offer three times, but it was not accepted. Tower withdrew the offer in March 2018, and replaced it with a lower offer of $28,216 – i.e. $55,030 less the professional fees that Tower considered were not payable.

This offer was also refused. The policyholder alleged it was owed $882,221 for Tower's alleged failure to correctly assess the full replacement value of the house. Tower replied by advising of its position that the limitation period for the making of a claim expired on 17 September 2018 – being six years from the date on which the construction contract was executed. The policyholder commenced proceedings, and Tower applied for summary judgment.

In its decision, the Court agreed with Tower that the time on the *"limitation clock"* ran from 18 September 2012, when the construction contract was signed. However, the policyholder argued that Tower's February 2018 settlement offer was an acknowledgement of liability for the purposes of section 47 of the Limitation Act 2010. Section 47 of the Limitation Act applies where a claimant proves that the defendant *"acknowledged to the claimant in writing a liability to, or the right or title of, the claimant"* or made a part payment in respect of that liability. If proven, the claimant is deemed to have a fresh claim on the day after the date on which the acknowledgment or part payment was given or made.

Tower argued that the February 2018 settlement offer was not an acknowledgement of liability to pay $55,030 *"come what may"* but rather a pragmatic offer to settle a disputed claim for damages. The insurer had not relinquished its right to defend the policyholder's claim either as to the $55,030 or generally and, indeed, the offer was for a greater sum than what the insurer believed the policyholder could possibly be entitled to.

The Court rejected all of these points. It held that the February 2018 settlement offer was an

acknowledgement of liability and declined to grant summary judgment on the basis that:

> (a) Tower offered pay $55,030 in full settlement of the earthquake related damage to the policyholder's house, and as such the letter was an acknowledgement of liability.
>
> (b) Regardless of whether Tower's letter was an acknowledgement of liability for $55,030 or for a lesser sum, the letter was an acknowledgement in writing of a liability to the policyholder. If some liability is acknowledged, it is immaterial that the amount at issue is disputed.

This case highlights the need to take care when making settlement offers where the claimant is running up against the applicable limitation period. Settlement offers may be interpreted as acknowledgements of liability, and have the effect of re-starting the limitation clock. If a settlement offer is to be made, careful thought should be given to how it is presented to ensure that section 47 is not triggered.

***E and E v IAG New Zealand Limited:*[2] referral of question of law on insurer's obligations to remedy defective repair work**

This case involves a successful application in the Tribunal to refer a question of law to the High Court. The question – which will have implications for many earthquake insurance cases – was:

> *Does an insurer's policy obligation to pay the cost of repairing the house to the policy standard, as and when incurred by the insured, include an obligation to also pay for the reasonable cost subsequently required to remedy defective repair work?*

In this case, IAG had accepted the plaintiffs' insurance claim. The plaintiffs entered into a building contract to carry out the repairs, and this contract was project managed by a third party. Both the builder and the project manager are now in liquidation.

When the contract works were completed, IAG paid the full contract price of $347,464.07. However, the plaintiffs were not satisfied with the work and commissioned various reports. From these investigations, they concluded that the repairs had been inadequately scoped and failed to address all of the earthquake damage. The house had been left damaged and it was not weathertight.

The plaintiffs considered that it would now cost $1,161,770 to reinstate their house to the policy standard and sought to recover that sum from IAG. IAG's position was that the plaintiffs should instead pursue those responsible for completing the defective repairs.

The Tribunal considered IAG's application to refer the question above to the High Court and agreed that a referral was appropriate. It was a question of law that required determination in the proceedings, and it had become a roadblock in this case – and others.

Insurers should keep an eye out for the High Court's decision on this question as, if it is answered positively, it may have the effect of extending their obligations to include remedying defective repair work carried out by others.

***M and M v IAG New Zealand Limited*[3] and *Mathieson v Tower Insurance Ltd:*[4] Tribunal and High Court issue decision on matters of policy interpretation**

The Tribunal and the High Court have both recently issued decisions on the interpretation of important insurance policy obligations.

M and M v IAG

M and M related to a dispute as to scope of works. IAG had accepted liability to repair earthquake damage to the house, and was willing to pay the reasonable cost of the necessary repairs. However, when the plaintiffs submitted plans, specifications and estimates to IAG for approval, IAG declined to approve six items in the scope of works on the basis that they were not necessary. The parties agreed to submit their dispute as to these six items for a preliminary ruling.

The plaintiff's policy provided, in relevant part, that:

You must ask for our permission before you:

- *incur any expenses in connection with a claim under this policy, or*

- *negotiate, pay, settle, or admit any allegation that you are legally liable, or*
- *do anything that may prejudice our rights of recovery.*

…

It is best that you allow us to manage your claim on your behalf. We'll let you know how you can help us when we talk to you about your claim.

The policy did not place any qualifications on the insurer's right to refuse permission for the policyholder to incur repair expenses.

However, the Tribunal considered that the insurer's decision-making powers did not exist in a vacuum and commented that it would be unconscionable to allow an insurer with an obligation to act with the utmost good faith to wield unbridled power over the repair or rebuild process.

The Tribunal held that it was appropriate to require the insurer to act reasonably, and that the best method of ensuring this was by implying a condition to that effect into the insurance policy.

The Tribunal held that the permission clause set out above was to be amended as follows:

You must ask for our permission before you:

- *Incur any expenses in connection with a claim under this policy, or*
- *Negotiate, pay, settle, or admit any allegation that you are legally liable, or*
- *Do anything that may prejudice our rights of recovery*

Provided however that we will always have due regard to your interests and will not unreasonably withhold our permission.

In respect of the six disputed items in the plaintiffs' scope of works, the Tribunal found that in five out of the six repair items, IAG had acted unreasonably in withholding permission.

This decision may be cause for concern amongst insurers. The usual rule provides that a term will not be implied into a contract unless it is necessary to give business efficacy to the contract or "*goes without saying*".[5] In this case, the Tribunal qualified a key policy term without reference to this rule – and it is not clear what it means to require an insurer to have "*due regard*" to policyholder interests.

***Mathieson v Tower Insurance Ltd*[6]**

Mathieson, a case before the High Court, also concerned the interpretation of an insurance policy.

In this case, the Tribunal referred three questions of law to the High Court for determination. The primary question was:

> The policy contained a warranty that the "maximum sum insured is $455,000". Was the $455,000 cap (less EQC payments) an overall cap on the amount that the policyholders could recover under the policy or did it apply as a cap per earthquake event?

This case concerned an indemnity policy, which insured the present day value of the plaintiff's home. *"Present Day Value"* was defined to mean *"the cost at the time of the loss or damage of rebuilding, replacing or repairing your house to a condition no better than new and up to the same area as shown in the certificate of insurance … but limited to the market value of the property less the value of the land as an unoccupied site".*

The policy schedule recorded that the plaintiffs had warranted that the market value of the house was $455,000. The plaintiffs had obtained a cost estimate which indicated that it would cost more than $3 million to repair the insured damage.

The policyholder argued, relying on *Ridgecrest NZ Ltd v IAG New Zealand Ltd*[7] and *QBE Insurance (International) Ltd v Wild South Holdings Ltd*[8], that the $455,000 cap could be claimed for each earthquake event on the basis that the sum insured automatically reinstated after each event.

The insurer disputed this. It said that it was only required to make one payment of $455,000, because the $455,000 cap

was an overall cap on the amount that the policyholders could recover under the policy. The insurer argued that it would be contrary to the indemnity principle if the policyholder received more than the market value of the dwelling.

The Court accepted the insurer's submissions and distinguished *Ridgecrest* and *Wild South*.

In *Ridgecrest,* the sum insured was described as *"the maximum amount you can claim under any Part [of the policy] in respect of one happening"* – or, in other words, per event. This was interpreted to allow for successive claims up to replacement value. By contrast, in *Mathieson*, there was nothing in the policy to suggest that the $455,000 cap was a per event cap. Rather, it was expressed to be a limit on the sum insured, to indemnity value only.

Wild South was also distinguished. In that case, the policy said that the sum insured reinstated *"from the date of loss or damage"*, while in Mathieson, the policy provided for reinstatement of the sum insured *"after we [Tower] meet any claim"*. The Court considered that because of this, the parties intended for reinstatement to occur when the policyholder's first claim was settled, and after the parties had an opportunity to consider whether to cancel or reinstate the policy.

For these reasons, the only way that the policyholder could make a second claim within the term of the policy was if the damage for the first claim was repaired before a second claim was made, or where the value of repairing the damage from the first claim was less than $445,000.

***Bolstad v The Earthquake Commission and Tower Insurance Limited:*[9] unsuccessful application to transfer High Court proceedings to the Tribunal**

In issue 18 of *Cover to Cover*, we discussed a number of High Court cases which suggest that, in general, the courts will take a broad approach in favour of applications to transfer proceedings to the Tribunal.

However, the plaintiff's application to transfer proceedings to the Tribunal in *Bolstad v The Earthquake Commission and Tower Insurance Limited* was unsuccessful.

In that case, the application was made at a relatively late stage. The parties' experts had completed a joint expert report, and the next step in the proceeding was for the parties to exchange briefs of evidence.

However, the outcome of the joint expert process made it difficult for the plaintiff to maintain its claim, as the parties' experts had agreed that the insured dwelling had not suffered any earthquake damage. The plaintiff did not accept that conclusion and, indeed, its claim could proceed without a new expert.

Rather than engage a new expert, however, the plaintiff applied for the proceeding to be transferred to the Tribunal, on the basis that the Tribunal has an inquisitorial function and could appoint its own expert to facilitate an expert conference. The cost of this expert would be met by the Tribunal.

The insurer opposed the application on the basis that it was not in the interests of justice:

> (a) First, the application was an attempt to challenge the conclusions of the joint expert report at the Tribunal's cost. This does not reflect the purpose for which the Tribunal was established.
>
> (b) Second, the Court should not be seen to assist the plaintiff in undermining the joint expert process by ordering a transfer to the Tribunal.

Associate Judge Lester accepted the insurer's submissions, further commenting that he doubted that the Tribunal would fund a further report aimed a contradicting a joint expert report.

1. Inicio Ltd v Tower Insurance Ltd [2020] NZHC 90.
2. E and E v IAG New Zealand Ltd [2019] CEIT 0013.
3. M and M v IAG New Zealand Ltd [2019] CEIT 0013.
4. Mathieson v Tower Insurance Ltd [2020] NZHC 136.
5. BP Refinery (Westernport) Pty Limited v Shire of Hastings (1977) 16 ALR 363.3. M and M v IAG New Zealand Ltd [2019] CEIT 0013.
6. Mathieson v Tower Insurance Ltd [2020] NZHC 136.
7. Ridgecrest NZ Ltd v IAG New Zealand Ltd [2014] NZSC 117.
8. QBE Insurance (International) Ltd v Wild South Holdings Ltd [2014] NZCA 447; [2015] 2 NZLR 24.
9. Bolstad v The Earthquake Commission [2019] NZHC 3283.

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