IN THE HIGH COURT OF NEW ZEALAND
CHRISTCHURCH REGISTRY

CIV-2012-409-002722
[2013] NZHC 1856

	BETWEEN	SKYWARD AVIATION 2008 LIMITED Plaintiff
	AND	TOWER INSURANCE LIMITED Defendant

Hearing: 15 July 2013

Appearances: K P Sullivan and GDR Shand for Plaintiff
R B Stewart QC and M C Smith for Defendant

Judgment: 30 July 2013

JUDGMENT OF D GENDALL J

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Introduction and factual background

[1] The plaintiff, Skyward Aviation 2008 Limited (Skyward), is the owner of a 1533m^2 property at 108 Kingsford Street, Burwood, Christchurch (being Lot 10 Deposited Plan 27737) (the property) on which stands a 207m^2 early 1900s villa home (the house) and a 64m^2 free-standing sleep-out built in 2009 (the sleep-out). Skyward is a landlord, having rented out the house and the sleep-out to residential tenants prior to the Canterbury earthquakes.

[2] The house and sleep-out on the property were affected by the 4 September 2010, 22 February 2011 and 13 June 2011 Canterbury earthquakes, ultimately suffering severe damage by liquefaction, lateral movement and sinking. At the relevant times the house and sleep-out were insured by the defendant, Tower Insurance Limited (Tower), under a replacement insurance policy described as a "Provider House (Maxi Protection) Policy".

[3] The property is situated within the residential "red zone" designated in Christchurch by Canterbury Earthquake Recovery Authority ("CERA") in June 2011. That red zone comprises specified areas of greater Christchurch where significant and extensive area-wide land damage has occurred and where the Crown concluded that land repair would be prolonged and uneconomic. As a result, the Crown therefore chose, through CERA, to make offers to purchase insured home owners' properties within the red zone at their 2007 value rating valuations.

Skyward accepted the Crown offer to purchase their land at a price of $291,000 and this amount has been paid to Skyward. It is no longer an option therefore for the house to be repaired or rebuilt on its current site at Kingsford Street.

[4] Skyward has settled its claim with EQC and Tower in relation to damage to the sleep-out, having received separate payments for this (including landscaping and professional fees) totalling $128,155. It has not, however, settled its claim for damage to the house which is the subject of this proceeding.

[5] What is also clear here is that to date Skyward has received additional payments totalling a further $659,670.53 for the property. These comprise:

(a) $291,000 from the Crown to purchase the land as noted above.

(b) $203,000 from EQC paid with respect to house damage in both the September 2010 and February 2011 earthquakes.

(c) $165,670.53 received from Tower, paid by it with respect to and on account of damage to the house. This payment has been made without prejudice to either party's position and on the express basis that "notwithstanding the payment, all of Tower's settlement options under the insurance policy remain open".

The total amount received by Skyward to date for the land, the sleep-out and the house is therefore $787,825.53.

[6] A disagreement has occurred between Tower and Skyward as to what notionally the house would cost to repair and accordingly whether it is economic to repair rather than to replace it through either purchasing another house or rebuilding an alternative house on some other site. Tower and Skyward also disagree as to whether Tower has already made an election as to how it will settle Skyward's claim under the policy.

[7] Helpfully, the parties concluded an agreed statement of facts for the hearing of this matter which states in part:

(a) Tower's position is that, but for Skyward's sale of its land to the Crown, the house could have been repaired on the Kingsford Street site at an estimated cost of $368,670.53 (as assessed by Tower's appointed loss adjuster, Stream Group).

(b) Tower says that a comparable replacement house could be purchased in the current market for $365,000 (excluding the land cost). That estimated land cost is a further $285,000. It reaches this position in reliance on a 2 May 2013 valuation from a registered public valuer, Mr G D Knight, in which he gives his estimation of a likely current cost of acquiring a comparable replacement house.

(c) Tower's position is that it has also received advice from Miles Construction that the estimated cost of rebuilding the house on standard NZS3604 compliant foundations on good ground on another site outside the red zone would be $712,223.91.

(d) Skyward's position based on its own quantity surveyor's revised report is that the house could notionally be repaired on the Kingsford Street site at a cost of $682,525.

(e) And, Skyward says the cost of rebuilding the house on standard NZS3604 compliant foundations on a site elsewhere would be $770,960.

(f) The 2007 Christchurch City Council rating valuation of the property was $582,000, comprising $291,000 for the land and $291,000 for the improvements.

(g) The same registered public valuer, employed by Tower, Mr G D Knight, has estimated the pre-earthquake market value of the land and home at 108 Kingsford Street (excluding the sleep-out) at $492,000.

(h) In a letter from its solicitors dated 6 May 2013 Tower set out its current position as follows:

(i) Under the policy it is Tower's election how it will settle Skyward's claims and it has not yet decided how it will settle Skyward's claim here.

(ii) Based on the estimates Tower has received, it appears that the most economic option for settlement of Skyward's claim would be the purchase of a comparable property elsewhere for $365,000 (plus land costs of a further $285,000).

(iii) Alternatively, the house could be repaired, according to Tower, for $368,670.53.

(iv) Therefore, Tower considers that the payments it has made to date are sufficient to discharge its obligations under the policy in the most likely settlement scenario.

(i) Skyward has not accepted Tower's offer set out in this 6 May 2013 letter. Its position as to repair and rebuild is that:

(i) As noted above, the house could be repaired on the existing property at a cost of $682,525 or rebuilt elsewhere for $770,960.

(ii) Skyward does not accept as correct either the estimates obtained by Tower of the cost of acquiring a comparable property in the current market, or the pre-earthquake market value of the property obtained by Tower.

(iii) Skyward disputes that Tower can elect to settle its claim under the policy by indemnifying it for the estimated cost of buying a comparable house.

(iv) Skyward says that Tower has elected here to make a cash settlement based on the full replacement value. If the house is economic to repair then Tower should cash settle for the estimated value of those repairs. If the house is not economic to repair then Tower should pay Skyward the full cost to rebuild the house.

What the hearing before me <u>was</u> about

[8] In minutes in this proceeding dated 17 May 2013, 29 May 2013 and 12 June 2013, Miller J made clear that this hearing was to consider three separate questions which had been discussed and were to be finally settled between counsel. He noted broadly in the 12 June 2013 minute at [2] that these questions were:

> ...shortly put, who has the relevant election under the policy, how the amount payable under the "buy another house option" is quantified, and whether on the facts of this case Tower has made an election to pay replacement value.

[9] On 24 June 2013, in a joint memorandum filed by counsel for both Skyward and Tower, those specific questions for resolution were finalised. They are:

(a) Under the terms of the insurance policy, on what basis is the amount payable by Tower to be calculated if a customer's claim is to be settled by Tower paying the cost of buying another house?

(b) Under the terms of the insurance policy, is it Tower's choice:

(i) Whether the claim is to be settled by Tower paying the cost of buying another house?

(ii) If settlement by Tower making payment is chosen, whether the payment is to be made based on the cost of rebuilding the insured house, replacing the insured house or repairing the insured house?

(c) In this case, by its emails of 9 September 2011, 29 November 2011 and 8 March 2012 did Tower make an irrevocable election to settle Skyward's claim by making payment based on the full replacement value?

The issues

[10] The issues before me therefore require a consideration of those specific questions outlined in the preceding paragraph and no others. Essentially, to borrow from Miller J's analysis outlined at [8] above, those issues seem to be:

(a) Under the policy, if the claim is to be settled by Tower making payment under the "buy another house" option, how is that to be quantified?

(b) Who has the relevant election under the policy – i.e. who chooses the basis on which the claim will be settled?

(c) On the facts of the present case, has Tower already elected how it will settle the claim and that this will be payment based on full replacement value?

What the hearing before me was <u>not</u> about

[11] Those questions outlined in [9] above do not address all matters in dispute between the parties. There are disagreements between the plaintiff and the defendant over the estimated repair, rebuild and replacement purchase costs. This decision is not about those quantum matters and the parties' disagreements regarding those costs.

[12] Next, and subject to the comments that follow later in this judgment, this decision is not about issues of waiver or estoppel which Mr Sullivan, counsel for the plaintiff, endeavoured to raise in his submissions before me.

[13] Finally, this decision is not about providing a full analysis of the claims process here, nor is it about what Skyward contends are the effects on it, as an owner of a red zoned residential property, of delays which are alleged to have occurred in settling its present claim.

[14] These matters, including disagreements between the parties' "experts" over the estimated repair/rebuilding/replacement purchase costs will not be resolved in this decision. The parties have said it is hoped that determination of the three specific questions outlined at paragraph [9] above will allow them to narrow and resolve their overall dispute without, in particular, technical matters relating to quantum needing to be determined here. If not, then those remaining issues will need to be the subject of a subsequent trial requiring factual and expert evidence. Generally, however, these matters are irrelevant to the determination of the questions which are before me.

[15] Shortly I will consider those three questions in turn. I need to say at the outset, however, that, according to the defendant, essentially the two legal questions outlined at [9](a) and (b) above have been the subject of a recent decision of this Court involving the defendant, Tower, and its identical policy terms. This decision, given a little over three months ago on 5 April 2013 by Asher J, was *O'Loughlin v Tower Insurance Ltd*,[1] Mr Stewart QC, for Tower, maintains that the findings in that case of Asher J on these two points were key parts of the ratio of his judgment. As I understand his submissions, Mr Sullivan, for the plaintiff, however, contends that Asher J's comments on these aspects were obiter but, in any event, he argues that the Court in the present case should depart from Asher J's reasoning. This is, according to Mr Sullivan, because Asher J has essentially taken the slightly unusual tack of seeking to change this policy from a full replacement "new for old" policy into one of present day value, an indemnity policy. That argument is strongly refuted by Tower, however. It maintains that I am being required here to depart from the reasoning of Asher J in *O'Loughlin* and to find that it was wrongly decided on these points. It is because of this direct challenge to *O'Loughlin* that, as I understand it, the present case before me has been set down with priority and, as a result, I have endeavoured to provide this decision speedily.

Policy Terms

[16] But first, I turn to the insurance policy itself and, as a starting point, a consideration of the wording of the policy.

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1 *O'Loughlin v Tower Insurance Ltd* [2013] NZHC 670.

[17] The main insuring clause in the policy provides:

> **What your house is insured for:**
>
> Sudden and unforeseen accidental physical loss or damage unless excluded by this policy.

And the certificate of insurance for this policy records that the house is insured for "full replacement based on area 210m^{2}".

[18] The insured property being the "house" is defined as follows:

> "**House**" means the domestic building(s) shown in the **certificate of insurance you** own at the **situation** including its fixtures and fittings (other than floor coverings not permanently fixed or glued in place, drapes and blinds), walls (other than retaining walls), gates, fences, underground and overhead services extending to the public mains, permanent swimming pools and spa pools (other than pumps or motors) and any other domestic structures on the same site (other than metal driveways or paths).

[19] It is common ground that the policy does not insure against loss or damage to the land beneath the house.

[20] Cover for "Natural Disaster Damage" is provided under a "Special Benefits" section in the policy in which Tower agrees to "pay the difference between the amount paid under EQ cover and the sum insured shown in the certificate of insurance". That reference to EQ cover is a reference to the cover provided by the Earthquake Commission (EQC) under s 18 of the Earthquake Commission Act 1993. As noted above, in the present case, Skyward has already received $203,000 from the EQC with respect to damage to the house. Tower's cover is top-up cover above this sum.

[21] Under the heading in the policy "How we will settle your claim" the following terms ("we" meaning Tower and "your" meaning Skyward's) are recorded:

> **We** will arrange for the repair, replacement or payment for the loss, once **your** claim has been accepted.
>
> **We will pay:**
>
> the **full replacement value** of **your house** at the **situation**; or

> the **full replacement value of your house** on another site **you** choose. This cost must not be greater than rebuilding **your house** at the **situation**; or
>
> the cost of buying another house, including necessary legal and associated fees. This cost must not be greater than rebuilding **your house** on its present site; or
>
> the **present day value**;
>
> as shown in the **certificate of insurance**.
>
> **We** will only allow **you** to rebuild on another site or buy a house if **your house** is damaged beyond economic repair.

[22] "Full replacement value" and "present day value" are defined in the policy terms as follows:

> **Full replacement value** means the costs actually incurred to rebuild, replace or repair **your house** to the same condition and extent as when new and up to the same area as shown in the **certificate of insurance**, plus any decks, undeveloped basements, carports and detached domestic outbuildings, with no limit to the sum insured.
>
> **Present day value** means 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**, plus any decks, undeveloped basements, carports and detached domestic outbuildings, less an appropriate allowance for depreciation and deferred maintenance, but limited to the market value of the property less the value of the land as an unoccupied site.

[23] The policy qualifies the "basis of settlement" clauses which I have outlined above in a number of important respects, including the following:

> **In all cases**:
>
> - **we** have the option whether to make payment, rebuild, replace or repair **your house**;
> - **we** will use building materials and construction methods commonly used at the time of loss or damage.

[24] Finally, the policy itself also limits Tower's obligations in other respects. On page 15 of the policy it states:

> **We are not bound to**:
>
> ...

- pay more than the **present day value** if **you** have **full replacement value** until the cost of replacement or repair is actually incurred. If **you** choose not to rebuild or repair **your house** or buy another house **we** will only pay the **present day value** and the reasonable costs of demolition and removal of debris including contents;

- pay the cost of replacement or repair beyond what is reasonable, practical or comparable with the original;

- repair or reinstate **your house** exactly to its previous condition.

Discussion of Policy Terms

[25] Turning now to questions of interpretation of the policy, it is well established in New Zealand that the interpretation of insurance contracts is to be approached in the same way as contracts generally – *D A Constable Syndicate 386 v Auckland District Law Society Inc*.[2] In addressing this task in commercial contracts *Vector Gas Limited v Bay of Plenty Energy Ltd* held:[3]

> The ultimate objective in a contract interpretation dispute is to establish the meaning the parties intended their words to bear.
>
> ...
>
> The necessary inquiry therefore concerns what a reasonable and properly informed third party would consider the parties intended the words of their contract to mean. The court embodies that person. To be properly informed the Court must be aware of the commercial or other context in which the contract was made and of all the facts and circumstances known to and likely to be operating on the parties' minds.

In *Molyneux Holdings Limited v IAG New Zealand Ltd* the Court of Appeal, when considering words in an insurance contract, stated:[4]

> Words are to be construed in context according to their natural and ordinary meaning but with such contracts being construed *contra proferentem* in the event of ambiguity or there being two meanings of equal cogency.

[26] Shortly, I will turn to consider the significance of each of the policy provisions, noted at [17] to [24] above, to the specific questions to be determined here. First, however, it is useful at this point to provide some general observations about the policy itself.

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2 *D A Constable Syndicate 386 v Auckland District Law Society Inc* [2010] NZCA 237 at [23].
3 *Vector Gas Limited v Bay of Plenty Energy Ltd* [2010] NZSC 5 at [19].
4 *Molyneux Holdings Limited v IAG New Zealand Ltd* [2007] NZCA 254 at [22].

[27] As to this, before me Mr Sullivan, for Skyward, emphasised the fact that first, the policy is described as, and understood to be, a full replacement value policy and, secondly, that the policy itself states that Tower will pay full replacement value. The meaning of those words, he says, is therefore critical to determining the measure of indemnity here.

[28] Next, Mr Sullivan noted that the policy provided a definition and standard for "full replacement value" which was to be to the "same condition and extent as when new". He contended this involved a "new for old" replacement. Whilst to some extent that may be true, it needs to be remembered at this point that clearly from other provisions in the policy (noted at [24] above), Tower is not required to pay the cost of replacement (or repair) beyond what is reasonable, practical or comparable with the original, nor is it required to repair or reinstate the house exactly to its previous condition. This was specifically referred to by Asher J in *O'Loughlin* where he stated:[5]

> ...To my mind the meaning is plain. The obligation is to replace with a property of the same general physical condition and size as the O'Loughlins' pre-earthquake home was, when new. It does not have to be an exact replica in terms of its physical position on the site or dimensions. It has to be comparable to the original house as when new. So a house that was not of good condition or was materially smaller in size or did not offer comparable amenities would not qualify.

[29] On these aspects, Asher J in *O'Loughlin* found specifically that the payment that the plaintiffs were seeking in that case, calculated on the basis of a notional rebuild of the house on its existing site in the red zone (which was not possible) would give the plaintiffs a windfall. This was because notional rebuild costs would be some $80,000 more than the actual rebuild costs that the O'Loughlins would incur on a sound non-red zone site.[6]

[30] In the *ANZ Insurance Commentary* (CCH) at paragraph 23.063 the following appears:[7]

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5 *O'Loughlin v Tower Insurance Ltd*, above n 1 at [177].
6 At [178].
7 Australia and New Zealand Insurance Commentary (online looseleaf ed, CCH) at [23-063].

> A contract of insurance may provide for replacement value (as opposed to market value, which is usually second hand value) to represent the measure of loss...
>
> Such policies are called "new for old" policies and are becoming increasingly popular, in particular in relation to personal effects, household contents and plant and equipment, although the premiums are inevitably higher.
>
> Subject to the terms of the contract, "reinstatement" or "repair" means the reinstatement, e.g. by repair, of the damaged property to its condition before the damage occurred; if the loss is total, reinstatement means replacing its property by its equivalent...
>
> The contract may expressly provide that the reinstated or repaired property will be in a condition "substantially the same as [or equal to] but not better or more extensive than its condition when new."

[31] And in *Chemainus Properties Limited v Continental Insurance Company* "replace" in an insurance context was defined as to "put back in place, to take the place of, succeed, be substituted for or provide substitution".[8]

[32] Before me, as I understood their respective submissions, there seemed to be no major disagreement between counsel for Skyward and counsel for Tower as to the general meaning of a full replacement value insurance policy. The initial matters outlined above were generally accepted on both sides.

[33] But, in doing so, Mr Stewart QC, for Tower, noted that the context for this was the principle of indemnity, a principle which was fundamental to insurance law. On this, he noted the comments of Brett LJ in the leading case of *Castellain v Preston*:[9]

> The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than a full indemnity, that proposition must certainly be wrong.

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8 *Chemainus Properties Limited v Continental Insurance Co* [1990] ILR 1-2574 at [40].

9 *Castellain v Preston* (1883) 11 QBD 380 at 386 (CA).

[34] This principle of indemnity was applied by our Court of Appeal in *Bryant v Primary Industries Insurance Co Ltd*[10] and in *AMP Fire and General Insurance Co (NZ) Ltd & Ors v The Earthquake and War Damage Commission*.[11] Notwithstanding this, it is clear the concept of "replacement cost insurance" was developed to rectify what was often seen as a shortfall between market value at the date of loss (being a measure of indemnity) and usually the significantly higher cost of replacement. Such policies cover the insured for the actual cost of replacement at the time the replacement is undertaken, as and when those costs are actually incurred. Mr Stewart QC contends that, provided the insurer's liability for replacement costs is tied to costs actually incurred by the insured, such policies are consistent with the basic principle of indemnity described in *Castellain v Preston*.

[35] Tower's policy in this case is an example of a type of "replacement cost insurance". As I have noted, when narrowing down their arguments on this aspect, there appeared to me to be little disagreement between counsel as to what "full replacement value" in the present policy meant.

[36] A second and, in my view, critical matter here, however, relates to the provision in the policy, noted at [23] above. This clearly reserves to Tower, as insurer, the right to choose in settling Skyward's claim, whether to pay money, or to itself rebuild, replace or repair the damaged house.

[37] As to these issues, in *O'Loughlin* Asher J specifically as follows:[12]

> It is usual for a reinstatement clause to provide the option of a payment, as an alternative to the restoration to the assured of the property damaged or destroyed. Which party has the option of choosing a payment rather than restoration, turns on what the contract says.
>
> ...it is stated specifically in this policy under the general heading that "in all cases" Tower has the option whether to make payment, rebuild, replace or repair the house. This sentence is quite unambiguous and explicit. It is the insurer and not the insured who has the option.
>
> ...

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10 *Bryant v Primary Industries Insurance Co Ltd* [1990] 2 NZLR 142 (CA) at 145.

11 *AMP Fire and General Insurance Company (NZ) Ltd & Ors v The Earthquake and War Damage Commission* (1983) 2 ANZ Ins Cas 60-529 (CA) at 78,021.

12 *O'Loughlin* v Tower Insurance Limited, above n 1, at [162] – [163] and [168].

> Tower has the choice, therefore, of whether to make a payment, or rebuild, replace or repair. It follows that Tower, in making the payment, can choose the basis of payment. That basis must be on a repair, rebuild or replacement basis and if repair is not an option, which I have found it is not, Tower can choose between rebuild and replacement.

[38] Although Mr Sullivan endeavoured to cast some doubt on these comments made by Asher J, in my view, they are unquestionable. The wording of the policy in this area is clear and unequivocal. It is Tower who can choose whether to repair, reinstate or rebuild the house or, instead, to pay money to Skyward on a similar basis as it sees fit. The purpose of reserving this election to an insurer was acknowledged by a leading commentator, M A Clarke, in the *Law of Insurance Contracts* as being:[13]

> ...to protect the insurer from excessive claims, to offer him a course that may be more economic than paying insurance money and, especially, in cases governed by the statute, to discourage arson and fraud.

[39] As noted in the policy provision outlined at paragraph [24] above, if Tower does elect to settle the claim by making a payment to Skyward, its obligation is to pay only the "present day value" up front "until the cost of replacement or repair is actually incurred" and then to indemnify the insured for costs if and when they are incurred above this sum. It is interesting to note that this in fact echoes the definition of "full replacement value" in the "Meanings of Words" section in the policy which refers to "costs <u>actually incurred</u> to rebuild, replace or repair" (emphasis added).

[40] I am satisfied that this limitation to "costs actually incurred" protects Tower as insurer against an insured's attempts to drive generous settlements by threatening to re-build when they might have no intention of doing so or if, for any reason, they do not ultimately do so. As I have noted above, the clear contractual provision in the policy provides for Tower to make an up-front cash payment of nothing more than the present day house value (presumably indemnity value) until replacement or repair costs are actually incurred.

[41] All this puts in stark relief the possible alternatives under the policy where, as here, significant damage has occurred and a claim is made.

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[13] M A Clarke, *Law of Insurance Contracts* (6th Ed, Informa, London, 2009) at 29-1.

[42] As a general overview, and given the options which rest with Tower to settle Skyward's claim, as I see it, the general range of settlement possibilities under the policy are as follows:

(a) The first group of options all entail Tower itself arranging for the repair, rebuild or replacement at its own cost. Broadly speaking, these are:

(i) Tower might choose itself to repair the damage to the house on the Kingsford Street site if it is, indeed, economically repairable. There is often a danger for an insurer like Tower in electing this option, as the *ANZ Insurance Commentary*:[14]

> If the insurer elects to do the repair itself, the policy would be treated as a repair contract and the insurer would be responsible for the quality of the work carried out. If it is defective, the insured could sue the insurer for damages to remedy that defect: *Robson v New Zealand Insurance Co Ltd* [1931] NZLR 35.

(ii) If the house is not economically repairable on the Kingsford Street site, then Tower might arrange to itself rebuild the house on the site to the same condition and extent and up to the same area as when new.

(iii) If the house is truly damaged beyond economic repair and is unable to be rebuilt on the Kingsford Street site, Tower may choose to itself rebuild the house, or to replace it (with an existing dwelling) (again to the same condition and extent as the original house when new, such that it is in all respects comparable) on a new site outside the red zone.

(b) The second group of options involve Tower making a decision not to carry out any repair, replacement or rebuild work itself, but instead to

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[14] *Australia and New Zealand Insurance Commentary* (online looseleaf ed, CCH) at [33-580].

cash-settle with Skyward for the loss, by making payments in one of the following ways:

(i) If Skyward intends to repair or rebuild the house on the Kingsford Street site, then Tower is to pay to it an amount representing the full costs at the time actually incurred to repair or rebuild the house (to the same area, condition and extent as when new).

(ii) If the house is in fact damaged beyond economic repair on the Kingsford Street site and Skyward wishes to rebuild on another site (outside the red zone) then Tower again in cash-settling with Skyward is to pay to it the full rebuild costs, being the costs actually incurred to rebuild the house (to the same area, condition and extent as when new) on that other site chosen by Skyward outside the red zone, provided that these costs must not be greater than a notional cost for rebuilding the house on its existing Kingsford Street site.

(iii) The next alternative for Skyward if the house is in fact damaged beyond economic repair is not to rebuild on a new site but instead to buy a comparable existing house outside the red zone. In this event, Skyward would need to communicate with Tower to negotiate what was accepted as a comparable house, given that the test is that the house needed to be, as far as possible, comparable to the Kingsford Street existing house in the same condition and extent as when new. When this was determined, Tower would pay the cost of buying that alternative existing house requested by Skyward, provided that, again, the cost involved was no greater than the notional cost of rebuilding the house on its present site.

(iv) The final option for Skyward would be simply to take a cash-settlement and not to repair, rebuild or buy another house. In

> this event the policy is clear. Tower is required initially to pay no more than the present day value (indemnity value) of the house and the reasonable costs of demolition and removal of debris, including contents. The policy stipulates that this is the only payment required of Tower at that point until Skyward actually incurs the cost of repairing the house (if it is capable of repair) or of rebuilding it or purchasing an alternative property. At that point, a top-up payment to the maximum cost level as provided at paragraph [42](b)(i), (ii) or (iii) above would be made.

[43] My general comments noted at [42] above seem to me to be broadly in line with the conclusions reached by Asher J on the same policy provisions in *O'Loughlin*. I will now turn, however, to consider the three specific questions which are before the Court here.

First question – under the terms of the insurance policy, on what basis is the amount payable by Tower to be calculated if a customer's claim is to be settled by Tower paying the cost of buying another house?

[44] This question relates to the cash-settlement option under the policy. Essentially, it raises the issue how the amount payable under the "buy another house option" is to be quantified. A proper starting point here is to consider, what was the parties' bargain when this policy was entered into. As I see it, what Tower promised was to indemnify Skyward for the cost of replacing its existing house. The various options for settlement under the policy are ways of delivering this result – either by Tower actually repairing or rebuilding the house, by Tower paying for Skyward to do so, or by Tower either acquiring or paying for Skyward to acquire a comparable replacement house.

[45] It is clear that the same general provisions applying in the policy to a repair or rebuild of the house also apply to replacement by the purchase of another house. The "full replacement value" definition outlined at [22] above refers to all three options – repair, rebuild or replace. Here, as different words were used in the definition clause, I am satisfied that "replace" must mean something different from

"rebuild" . In my judgment, logic would seem to suggest that it can only refer to the other option under the policy of purchasing a replacement property. Although before me Mr Sullivan, for the plaintiff, appeared to take issue with this and in doing so he referred me to the decision of Whata J in *McLean v IAG*, as I see it his argument lacks substance. In the *McLean* decision, the clause in question referred to "repair or replace" and His Honour held that replacement in that context included replacement by rebuilding. The clause in the present case is materially different, referring to "repair, replace or rebuild". In this context "replace" must be seen as something different from "rebuild".

[46] How then is the amount of the payment which Tower must make to be calculated in terms of the policy if Skyward's claim here is to be settled by Tower paying the cost of buying another house? The answer to this question, as I have noted above, is simply that Tower's obligation under this replacement option is the same in principle as that for a repair or rebuild and requires:

(a) As a fundamental starting point, a proper consideration of the size, construction, condition, style and extent of the house as when new on a sound site; and

(b) An obligation on Tower to indemnify Skyward for actual costs incurred to replace the house to this condition, to the extent replacement in such a manner is reasonable, practical and comparable with the original; and

(c) The obligation on Tower is subject to the proviso that it is not obliged to pay more than the notional cost of rebuilding the house on its existing Kingsford Street site.

[47] My conclusion outlined in the preceding paragraph, as I see it, is entirely consistent with the position reached by Asher J when he considered the identical policy provisions in *O'Loughlin*:[15]

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[15] *O'Loughlin* v Tower Insurance Ltd, above n 1, at [181] – [182].

> I conclude therefore that Tower's obligation is to make a payment based on a rebuild or replacement for a comparable house to the O'Loughlins' house to the same condition and extent as when new on a sound site in Christchurch. The replacement house would have to be of comparable size and condition as when new, and offer the same amenities.
>
> The notional rebuild costs have been calculated on such a notional good site. The figure is $540,000. I do not accept therefore the rebuild figure of $620,000. I am not able to determine what the cost of a replacement house comparable on this basis to that of the O'Loughlins would be, as that would be a matter of up to the minute expert valuation opinion. Such a figure could not be determined unless particular comparable houses that were on the market were located. Their value, putting to one side the value of the land, would have to be calculated. There would be a question of whether any proposed replacement house was comparable, and met the full replacement valuation definition of "to the same condition and extent as when new".

[48] All this follows the definition of "full replacement value" on page 17 of the policy (noted at [22] above) being the cost actually incurred to replace the house to the same condition and extent as when new and up to the same area as shown in the certificate of insurance, plus any decks, undeveloped basements, carports and detached domestic outbuildings, with no specific limit to the sum insured.

[49] And, as I have noted at [39] above, this is subject to the proviso in the policy that Tower is not bound to pay more than present day value until the cost of replacement is actually incurred. If the insured decides against buying another house then Tower would only be obliged to pay the present day value and the removal costs of demolition and removal of debris, including contents.

[50] All this is subject to the further proviso, noted at [24] above, that Tower is not bound to pay the cost of replacement beyond what is reasonable, practical, or comparable with the original. On these matters, before me Mr Stewart QC, for Tower, acknowledged that in practice Tower would seek to reach agreement with its insured on a property which is reasonable, practical and comparable with the insured property. The first step would be for Tower or Skyward to identify potential properties which would be seen as comparable and would qualify as a replacement house. Hopefully then, agreement could be reached between them. Failing agreement, however, Skyward, as the insured, could decline a replacement property suggested by Tower in which case it would receive a payment representing the present day value of the Kingsford Street house until a suitable replacement property

was located and settled upon. Alternatively, Skyward, as insured, could apply to the Court for an order as to the appropriateness of any particular replacement property which either party had identified.

[51] What constitutes a replacement house would need to be determined on the facts of each particular case. Although plainly it would not require the purchase of a "brand new" house, it could be that. Such a property, or a comparable second hand house, might meet the test of being an acceptable replacement property in a particular case.

[52] In this regard, Asher J in *O'Loughlin*, which I have referred to at [28] above, set out what I consider to be an appropriate general test which I adopt. It is useful to repeat this here:[16]

> The obligation is to replace with a property of the same general physical condition and size as the O'Loughlin's pre-earthquake home was, when new. It does not have to be an exact replica in terms of its physical position on the site or dimensions. It has to be comparable to the original house as when new. So a house that was not of new condition or was materially smaller in size or did not offer comparable amenities, would not qualify.

[53] By way of example, a rebuilt or comparable replacement house in this case might comprise the following features:

- An approximately 207m^2 replica early 1900s villa home on sound foundations, with verandahs;
- Exterior construction of weatherboard and wooden joinery in a similar style with iron roof;
- High interior roof stud;
- Exposed solid timber floors (possibly tongue and groove construction) if appropriate;
- Plasterboard walls and (possibly decorative) plaster ceilings;

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16 At [177].

- Fireplaces or fireplace facades (if appropriate);

- Timber interior joinery, doors, skirting boards and architraves;

- Reasonable quality replica-type internal fittings.

Given also that in terms of the policy Tower is not bound to pay the cost of a rebuilt or replacement house beyond what is reasonable, practical or comparable (and not identical) with the original, it seems to me that, where appropriate here, equivalent modern materials and construction methods could be used in any comparable house.[17] And, any valuations to establish what might constitute the reimbursement cost of a comparable replacement home could also take all these matters into account.

[54] Mr Sullivan complained that at a practical level, Tower is trying here to "force" Skyward to buy another house which it cannot do. As I see the position, however, that is not correct and it also misses the point.

[55] It is Tower's choice to indemnify the insured for the cost of buying a replacement house as one option under the cash settlement provisions. This does not "force" the customer to buy a particular house. It simply means that if Skyward, as the insured, does not purchase a replacement house, then Tower's payment to it will be limited to the pre-earthquake market value of the house, that is its present day value, until such time as a comparable replacement house is in fact purchased.

[56] An essential position also advanced by Skyward is that the payment Tower is required to make for the purchase of another house can only be determined here by applying, as a maximum sum, the costs of a true rebuild. Otherwise, he suggests, this is not a full replacement policy. Rather, Mr Sullivan contends, this is precisely what Tower now seeks to improperly reduce Skyward to. He claims that Tower's argument here is evidently an indemnity only approach, based on present day value. In my view, however, these arguments advanced by Mr Sullivan are wrong. The terms of the policy are clear. They provide for replacement of the existing house by

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[17] See *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd* [2012] NZHC 3344.

one that is comparable (when considered new on a sound site) and, as an alternative, a cash-settlement payment by Tower calculated on this basis.

[57] As I see the position, many of Mr Sullivan's other arguments for Skyward on this question relate essentially to valuation and quantum issues. Those are separate matters.

[58] In terms of this first question outlined at [44] above, the amount to be payable by Tower, where it is to pay to Skyward the cost of buying another house, is to be the fair price of a replacement house which is to a reasonable and practical extent comparable, of the same 207m^2 size and construction (as far as may be possible), in the same condition, and of the same style and extent (more or less), as the Kingsford Street house was when new. This could be a new or (more likely) a second hand house sited outside the red zone. As to whether its size, construction and quality were reasonably comparable, these would all be determined on the facts of this particular case. In this regard, the broad house features in the example I have provided at [53] above might, to some extent assist. For valuation purposes, as I see it, such a reasonably comparable replacement house might first be identified and then be the subject of one agreed valuation (or alternative independent valuations) to arrive at that fair replacement price. And finally, of course, payment by Tower would be subject to the provisos noted at [46](c) and [49] above.

[59] As to the practicalities of purchasing a replacement house or, alternatively, calculating a payment figure for this replacement option, as recently as 29 May 2013 in a minute issued by Miller J, His Honour did not seem to see any practical difficulties in this:[18]

> ...I record that Skyward is concerned about how Tower will quantify the payment if Tower's view of the buy another house option is correct, but Mr Smith [for Tower] confirmed that Tower accepts it is a question of the insured selecting another house and securing Tower's agreement that it is comparable, at which point Tower will pay the cost of purchase. Any cash payment in advance of an actual purchase would seem to be a matter for negotiation rather than adjudication.

[18] Minute of Miller J dated 29 May 2013, at [2].

[60] And, in *O'Loughlin*, Asher J noted:[19]

> [199] It is not possible at this point to be prescriptive as to how, if Tower wishes to elect the replacement option, the parties should go about that process of calculating the correct figure. Normally if it was an actual replacement there would be a co-operative situation with a comparable replacement property in terms of the policy being found and agreed. In the event of a payment in lieu of actual replacement, the process is less easy to define without the issue being argued. In the end, if that path is pursued and there is an impasse, the parties could seek a declaration or judgment for a specific sum.

[61] My answer to the first question set out at [44] is simply that the amount to be payable by Tower, is to be the fair price of a replacement house which is to a reasonable and practical extent comparable, of the same 207m^2 size and construction (as far as may be possible), in the same condition, and of the same style and extent (more or less) as the Kingsford Street house was when new. As already noted, however, at a practical level, this figure may require a valuation exercise and some negotiation between the parties. And this process would include, as a backstop in the event of intractable disagreement, the possibility of an application being made to the Court for a declaration or judgment for a specific amount thought to be appropriate.

Second question - under the terms of the insurance policy, is it Tower's choice:

(i) Whether the claim is to be settled by Tower paying the cost of buying another house?

(ii) If settlement by Tower making payment is chosen, whether the payment is to be made based on the cost of rebuilding the insured house, replacing the insured house, or repairing the insured house?

[62] Turning to consider the first part of this question, in my view, it is quickly disposed of. The policy here expressly provides that <u>in all cases</u> Tower has the option whether to make payment, rebuild, replace or repair the house. Unquestionably, this choice lies with Tower as the insurer, and logically must include a choice to settle Skyward's claim by paying the cost of "replacement" which, in terms of the policy, includes paying the cost of buying another house – see paragraphs [42](a)(iii) and [42](b)(iii) above.

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[19] *O'Loughlin v Tower Insurance Ltd*, above n 1, at [199].

[63] In *O'Loughlin* Asher J considered this provision and stated:[20]

> As set out above, it is stated specifically in this policy under the general heading that "[i]n all cases" Tower has the option whether to make payment, rebuild, replace or repair the house. This sentence is quite unambiguous and explicit. It is the insurer and not the insured who has the option.

[64] That this provision is not unusual in policies of this type is clear. On this aspect, it is useful to note certain comments relating to property insurance in *Australia and New Zealand Insurance Commentary*:[21]

> Which party has the option of choosing the form of indemnity turns on what the contract says. The option to decide whether the insurer makes payment, rebuilds, replaces or repairs the insured's home is usually stated by the policy to be with the insurer.

[65] And, as I understand his submissions before me, Mr Sullivan, for Skyward, accepted that there was no real dispute that the policy made clear that Tower had this election.

[66] That disposes of the first portion of question two, the answer for which must be "yes". It is Tower who has the relevant election under the policy, and thus it is Tower's choice whether the claim can be settled by paying the cost of buying another house.

[67] Turning now to the second aspect of this question, I am satisfied that it is Tower which chooses the basis on which payment is to be made. This follows necessarily from the terms of the policy and the fact that Tower is entitled to choose which option is used to settle the claim.

[68] On this, I agree with the comments of Asher J in *O'Loughlin* where he states:[22]

> Tower has the choice, therefore, of whether to make a payment, or rebuild, replace or repair. It follows that Tower, in making the payment, can choose the basis of payment. That basis must be on a repair, rebuild or replacement basis, and if repair is not an option, which I have found it is not, Tower can choose between rebuild and replacement.

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[20] At [163].
[21] *Australia and New Zealand Insurance Commentary,* above n 14, at [33-580].
[22] *O'Loughlin v Tower Insurance Ltd,* above n 1, at [168].

[69] In addition, if Tower chooses to make a cash settlement payment under the policy, the fact that Tower's choice here extends to determining the basis of payment, in my view, tends to be confirmed also by the proviso to the basis of settlement clause itself which states:

> We [Tower] will only allow you to rebuild on another site or buy a house if your house is damaged beyond economic repair.

[70] The only situation in which Skyward would itself be rebuilding or buying another house is if Tower has elected, generally, to make a cash-settlement payment rather than to repair, rebuild or replace itself. The policy and this proviso in part, however, make clear that, even in this situation, the ultimate choice about whether a settlement payment is calculated by way of repair, rebuilding or replacement remains throughout with Tower.

[71] Mr Sullivan, for Skyward, whilst accepting that the clause in the policy, outlined at [23] above, gives Tower the choice between reinstating the property or paying its equivalent cost, endeavoured to argue that Tower's choice does not extend to determining the basis of payment. On this, Mr Sullivan also submitted that:

> If an election is made by Tower to make payment it is not any business of the insurer whether the insured uses the money to buy a house, build a house or put the money in the bank. That is a consequence of the election to make payment.

[72] This submission, however, in my view, is quickly disposed of. It ignores the plain words of the policy set out at [24] above. The proposition that Skyward is entitled to receive payment on a reinstatement basis, but then does not need to use the money it receives to actually complete reinstatement but is able to simply put it in the bank, is fundamentally inconsistent with the general insurance principles of indemnity and the express terms of the policy here.

[73] Where Tower elects to make a cash-settlement payment, clearly it is not obliged to pay anything more than the "present day value" unless and until the costs of repairing, rebuilding or replacing, are actually incurred.

[74] At a practical level, Mr Stewart QC indicated that in situations such as the present, Tower will endeavour to reach agreement with its policyholders amicably on the method of settlement of their claims and is usually able to do so. Payments made on the basis of the estimated cost of reinstatement, or for the purchase of a comparable replacement property, can be agreed. However, where agreement cannot be reached and there is a significant monetary gap between the parties, as seems to be the case here, ultimately Tower can choose which of the settlement options under the policy it will adopt in relation to the insured's claim. If Tower chooses to indemnify the insured for the cost of buying another comparable replacement house, this cannot be said, however, to "force" the customer to buy that house. It simply means that, if Skyward chooses not to accept payment on this basis to settle its claim, Tower's payment will be limited to the pre-earthquake market value of the house, until such time as actual costs of rebuilding or replacing the house are incurred by Skyward.

[75] In this scenario, Skyward, as the insured, would not be out of pocket because it has not incurred the cost of actually replacing the Kingsford Street house and would still receive the cash value of its asset before the loss. Therefore, it could be said that Skyward is indemnified for its actual loss.

[76] This disposes of the second portion of question two, the answer for which must again be "yes" – if Tower chooses to settle the claim by making payment, in terms of the policy, it is Tower's choice whether that payment is to be made based on a fair and reasonable assessment of rebuilding, repairing or replacement cost.

Third question - in this case, by its emails of 9 September 2011, 29 November 2011 and 8 March 2012, did Tower make an irrevocable election to settle Skyward's claim by making payment based on the full replacement value?

[77] The policy in this case, as I have noted at [21] and [23] above, contains two provisions that set out the nature of Tower's available election under the heading "How we will settle your claim":

> **We** will arrange for the repair, replacement or payment for the loss, once **your** claim has been accepted.
>
> **In all cases:**

- **We** have the option whether to make payment, rebuild, replace or repair **your house**.

[78] The legal principles applicable to election are not in contention. In the *Australia and New Zealand Insurance Commentary* this matter is addressed:[23]

> The insurer must make an election as to which option it chooses to take. The words or conduct ordinarily required to constitute an election must be unequivocal in the sense that it is consistent with only the exercise of one of the two sets of rights and inconsistent with the exercise of the other, such as the insurer's acceptance of the premium with knowledge of a ground for avoidance will be inconsistent with the right to avoid...To be unequivocal, the election must be unqualified...and this will not be met if for example, the insurer's election is accompanied by a requirement that the insured do something that he or she is not required by the contract to perform, such as contributing in some way to the cost of the repair of insured property, even repair that does not lie on the insurer...
>
> Unless a time is fixed by the contract of insurance, the option to reinstate or replace must be exercised within a reasonable time...A formal election is not required, but once made it cannot be withdrawn, even if the decision later proves unwise...If the insurer elects to reinstate, the insured cannot insist on a monetary payment and if the insurer elects not to reinstate, the insured cannot insist on reinstatement...

[79] Whether or not an election may have been made in any case is an issue to be determined on the particular facts of that case. *MacGillivray on Insurance Law* explains: [24]

> **22-004 Election to pay or reinstate**
>
> Once the insurer has made his election he is bound by it and cannot thereafter change his mind. But it may often be difficult to say whether conduct of any kind by the insurer constitutes an election...
>
> In light of these authorities, it is not easy to lay down any general principles as to what conduct constitutes an election, since in each case it is a question of fact. However, a Court would be reluctant to hold that an insurer had exercised an election by conduct unless it was satisfied that the insurer had all the available information before him on which to decide which of the two courses was more advantageous to him. In particular, a mere offer to settle by payment of a certain sum of money would probably not of itself be an election to pay if that offer is refused. Insurers would, however, be wise to state that any such offer was made without prejudice to their right to reinstate

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23 *Australia and New Zealand Insurance Commentary*, above n 14, at [23-180].

24 *MacGillivray on Insurance Law*, (12th Ed, Sweet & Maxwell, London, 2012) at [22-004] – [22-005].

[80] In this case, Skyward's position, in broad terms, is that Tower has elected to cash-settle its claim on the basis of the costs of repair, that this occurred nearly two years ago, and that Tower cannot now change its mind and re-open other settlement options.

[81] In response, Tower's position is that the dealings between the parties were merely correspondence which, at best, involved an offer by Tower to cash settle for a specific sum which happened to be calculated by reference to a particular repair cost estimate referred to in correspondence, but that this was not an election. Tower says this offer to cash settle was at no time accepted by Skyward and, as noted at [79] above in the passage quoted from *MacGillivray*, such an unaccepted offer cannot constitute an operative election.

[82] On all of this Mr Sullivan, in his submissions for Skyward, referred to the entire claim process history here. He began with reference to a report from Tower's claims adjuster, Stream, dated 27 November 2010, sometime after the September 2010 earthquake. That report is before the Court and, of course was completed before the idea of red zoning was in consideration. The report suggested remediation by re-piling and replacement of a perimeter strip foundation as the most likely option but, even at that point, the cost was seen as possibly prohibitive.

[83] Next, Mr Sullivan referred to a further report from Stream, some six months later, on 1 June 2011 which, at that time, showed a replacement proposal for the house totalling $435,551.06, albeit the particular materials to be used were to become the subject of some discussion after these Court proceedings were filed and the plaintiff had engaged its own quantity surveyor.

[84] Despite initial indications that the house was economic to repair, which it is said occurred at a meeting on site with Stream representatives, the red zoning of the property intervened. Re-assessments took place in light of that red zoning, but Skyward contends that Tower determined that, despite the severe damage which had occurred to the property, a repair would still be feasible. That re-assessment, it is said, took place in June 2011 and at about the time the red zoning was announced, but did not culminate in a new written report from Stream until 1 September 2011.

That report is before the Court and, according to Skyward, it indicates first, that repair of the house was feasible and, secondly, it sets out settlement options to cash settle based on figures outlined there.

[85] Under the settlement options in that Stream report, repair and rebuild estimates only were set out. The report appeared to conclude that with foundation modification it would be feasible to repair the house. As an aside at this point, it does seem that the mention of foundation modifications in effect ignored the fact that the foundations were substantially damaged, because at that time Tower appeared to take the view that the land and, indeed, the foundations, were EQC's problem, not Tower's. Mr Sullivan, for Skyward, then refers to an email message dated 29 November 2011 from Tower to Skyward's director which, amongst other things, states:

> At this time Tower Insurance believes the house is repairable. I can arrange for an on-site meeting if you would like to discuss the repair process and to ensure we have covered all of the damage.
>
> As your property is in the red zone the settlement will be a cash offer based on the repair costs.

Details of suggested repair costs followed with a final comment in the email:

> Please let me know what you would like to do – either a site meeting or take a cash-settlement on the properties, or if you take Option 1 from CERA please let us know this as well.

[86] The email assessed Tower's total liability at that time for damage to the house and hard landscaping as $103,890.80 (taking into account EQC's liability for the excess). Skyward notes now that this cash amount being offered to it by Tower was substantially less than a recent repair value assessed by Skyward's own quantity surveyor. Issues of quantum, however, as I have noted above, are outside the considerations to be made in this judgment.

[87] Following this 29 November 2011 email, representatives of Skyward sought legal advice and by 5 March 2012 it was clear that Skyward did not wish to accept the cash amount offered and requested a site meeting.

[88] Tower had set out its position more fully in an email dated 31 January 2012, and a later email dated 5 March 2012, which explained that its basis for calculating the costs to be incurred was to treat the land as being in good condition, and providing a good building platform.

[89] Skyward now contends that Tower's settlement position, if it was not already clear, was made abundantly so on 6 March 2012. This was as a result of an email dated 6 March 2012 sent by Mr Peter Richardson, Skyward's solicitor, to Tower. Amongst other things, that email stated:

> Our client's (Skyward's) understanding is that Tower's position is as follows:
>
> 1. The properties are physically repairable, but
>
> 2. In practice cannot or will not be repaired by Tower because they lie within the Red Zone, and
>
> 3. Accordingly Tower is entitled to settle the claim by payment to our client of the estimated repair costs.
>
> Please would you advise immediately whether that indeed is Tower's position.

[90] This was followed the next day by an email from a representative of Tower to Mr Richardson which confirmed as correct the points noted at [89] above in Mr Richardson's earlier email.

[91] A site meeting of the parties did not take place until 29 March 2012. Subsequently, a scope of works was drawn up by Tower, but apparently no agreement on this was reached. Skyward then obtained its own expert evidence and the present proceedings were issued on 6 December 2012.

[92] Mr Sullivan contends that even during the course of this present litigation, the terms of interim settlement were agreed on the basis that all of the professional fees for rebuilding or repairing the house had been paid as part of the sleep-out settlement. He went on to contend that whilst an interim settlement payment which had been made by Tower for the house sought to reserve rights of election, in fact it was a full payment of the amount Tower said was the cost of repair.

[93] Accordingly, it is Skyward's position that Tower has done more than elect the basis of payment – it has actually made an initial payment based on that election. In electing to pay based on the cost of repairing the property, Skyward contends that it is wholly inconsistent for Tower now to endeavour to offer to settle at the cost of buying a second hand house.

[94] Skyward says the only issue outstanding is whether Tower has indeed paid enough to repair the house to satisfy its fundamental obligation to pay full replacement value.

[95] In response, as I have noted above, Tower's position is that no election has been made here and that all it was doing in the emails relied on by Skyward was making an offer to cash-settle at a sum, calculated by reference to a particular repair estimate at the time and that this offer was not accepted.

[96] At the outset, Mr Stewart QC, for Tower, notes that [30] and [31] of Skyward's statement of claim acknowledge the relevant correspondence was described as being an "offer" by Tower which Skyward refused. Then, in January and February 2013 Tower maintains that Skyward in fact accepted the stipulation that the interim payment made by Tower in relation to the house was made on the basis that "notwithstanding the payment, all of Tower's settlement options under the insurance policy remain open."[25] It is said that it was not until after the judgment of Asher J in *O'Loughlin* on 5 April 2013 that Skyward began to suggest that Tower had indeed made an election here. Mr Stewart QC says the issue was raised for the first time in a memorandum of Skyward's counsel dated 27 May 2013.

[97] On these matters, Tower's position is that its offer was made in the context of the red zoning of Skyward's property. Tower says that it appreciated that insureds with homes in the red zone would not wish to have their properties actually repaired or rebuilt as their policies could require as a condition of payments being made. In these unique circumstances, Tower says it was therefore prepared to offer to cash settle on the basis of the estimated costs of reinstatement, in effect waiving the

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[25] Letter from Tower's solicitors, Gilbert Walker, to Skyward's barrister, Mr Sullivan, dated 29 January 2013.

requirement under the policy that the actual costs of reinstatement be incurred before payment was made. Mr Stewart QC notes that many of Tower's customers were pleased to receive these cash offers and accepted them, but Skyward did not do so.

[98] As noted above, Tower's position is that its correspondence here clearly comprised an offer outside their insurance contract and not an election under the policy. The offer was rejected by Skyward. Mr Stewart QC goes on to maintain that this correspondence could never have been seen as an election, for the simple reason that an upfront payment of the estimated cost of repair of the house is not an available settlement option under the policy. A settlement on this basis could only be achieved, he contended, by a separate settlement agreement with the insured, outside the strict contractual terms.

[99] Mr Stewart QC then contended that the situation in the present case is analogous to that which prevailed in a decision of the Queensland Supreme Court in *Cape York Airlines Pty Limited v QBE Insurance (Australia) Limited*.[26] In *Cape York*, the insurer endeavoured to argue that it had made an election to carry out repairs. The relevant correspondence comprised the insurer tendering estimates of the cost of repair and requesting that the insured instruct the tendering contractor to carry out those repairs. The Court held that this correspondence did not amount to an election to repair for the simple reason that it was not a choice of a settlement option under the policy. Daubney J made the following comments:[27]

> But it is also clear that a party purporting to make an election can only make a choice between the suite of options available under the relevant contract. In a case such as the present, where a suite of choices is available, the electing party is plainly limited in its range of choices. A purported election by it of an option which is not within the available range is no election at all.
>
> ...
>
> This letter was not, in my view, clear and unequivocal notification of the option "to repair" given under the Policy. What it was, rather, was a request by the defendant for the plaintiff to instruct ASIC "to proceed with the repairs to the Aircraft as per their estimate". That was not one of the options within the suite available to the defendant under the Policy.

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26 *Cape York Airlines Pty Ltd v QBE Insurance (Australia) Ltd* [2010] QSC 313.

27 At [120] and [123].

[100] In *Cape York*, the Court noted that the insurer's correspondence was simply part of settlement manoeuvring which, whatever else could be said about it, did not amount to an election to pay or to reinstate under the policy:[28]

> It is also abundantly clear from the contemporaneous correspondence that the defendant was seeking to employ the tactic of fixing the plaintiff with the quantum of ASIC's repair estimate for the purpose of negotiating a cash settlement. There is, of itself, nothing objectionable about the defendant seeking to compromise on its rights once it has properly made an election. That is clearly not what was happening here. But whatever extra-contractual manoeuvring the insurer was seeking to engage in for the purpose of snaring a favourable settlement is irrelevant to the present question of whether the letter of 26 February 2004 was evidence of the defendant having elected to repair the Aircraft. For the reasons I have given, I consider that it was not.

[101] Tower's position essentially therefore, like that which was adopted in the *Cape York* decision, is that there is no scope for any finding that it has made an election under the policy to pay cash to Skyward based upon estimated costs of repair. This is, at least in part, because Tower says this was not an option under the policy. In my view, there is merit in this argument.

[102] But, notwithstanding this, a brief analysis of the correspondence between the parties is useful here.

[103] On this aspect, Skyward relies for its election argument on three specific emails from Tower dated 9 September 2011, 29 November 2011 and 8 March 2012.

9 September 2011 email

[104] This is an email from a Tower customer service officer to Skyward's representatives. It annexes a "settlement proposal report" from Tower's external loss adjusters, Stream Group, giving the opinion that the property is repairable at an estimated cost of $320,200. In light of this report and EQC's payments to that date, at the foot of the first page of the email it is stated:

> **Settlement options:**
>
> 1. Tower Insurance can arrange to cash settle the amounts for the repairs to the driveways, paths, fencing, and the outstanding liability from the September event = $96,000.

[28] At [126].

2. Tower Insurance can arrange to cash settle the amounts for the repairs to the driveways, paths, fencing for the February event of $109,200.

[105] Tower contends that this email was plainly not an election under the policy that it would make payment to Skyward based on the cost of repairs and I agree. It does not refer anywhere to the repairs actually being carried out, but instead it simply proposes without condition a cash-settlement payment as a possible settlement option.

[106] Tower's position is that the reason for this is that all parties were operating on the basis that the repair estimate was notional – repair works would not be carried out because Skyward's property was in the red zone. The purpose of the exercise was for it to accommodate those circumstances by extending an offer not contemplated by the strict policy terms, that is, to make a specified cash payment to Skyward in settlement of the claim. Tower says this was simply a part of its overall attempt at the time to resolve the difficult situation which had arisen with all its red zone insureds and this offer, which was effectively an extra contractual one, could not be capable of being seen as an election under the policy. I agree.

29 November 2011 email

[107] This email appears to be a continuation of the same series of correspondence. The sentence relied on by Skyward states:

> As your property is in the Red Zone the settlement will be a cash offer based on the repair costs.

[108] Tower's position is that for the same reasons outlined above in relation to the 9 September 2011 email, this later email is incapable of being an election of a settlement option under the policy. Again, I agree. This email in the penultimate paragraph also requests Skyward to "let me know what you would like to do – either a site meeting or take a cash settlement on the properties..." As I see it, the overall thrust of the email was clearly to indicate an extra-contractual offer in an endeavour to manoeuvre a settlement of Skyward's claim. I find this email is not an election by Tower under the policy.

8 March 2012 email

[109] This email follows a 6 March 2012 email from Skyward's solicitor to Tower's customer service officer. That 6 March 2012 email included a request from Skyward's solicitor for confirmation of Tower's position stating:

> Our client's understanding is that Tower's position is as follows:
>
> 1. The properties are physically repairable, but
>
> 2. In practice cannot or will not be repaired by Tower because they lie within the Red Zone, and
>
> 3. Accordingly Tower is entitled to settle the claim by payment to our client of the estimated repair costs.

[110] The 8 March 2012 response from Tower's customer service officer stated:

> Peter your points from your email are correct.

[111] Although Skyward contends that the language in this email confirms that an election had been made, Tower's position is that this language could not in any way be construed as providing an election on its part. Tower says that Skyward's solicitor's third point, noted at paragraph [109](3) above, simply describes what Tower considers its entitlement to be and, in any event, Tower says limited weight should be given to this effort by Skyward's solicitor to put words into the mouth of a non-lawyer. According to Tower, this email cannot change the fact that payment of the estimated cost of repair is not a basis of settlement available under the policy so even a purported "election" to do so could not be an election for the purposes of the policy.[29]

[112] The final additional point raised on behalf of Tower here is that the closest settlement option under the policy to the offers made by Tower in its correspondence would be to make payment for an actual repair. On this, Tower has denied throughout that it has made any election to do so. However, it says that, even if Tower had made such an election, Skyward has subsequently put it beyond its power to repair the property by selling its land at Kingsford Street to the Crown. Skyward

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[29] *Cape York Airlines Pty Ltd v QBE Insurance (Australia) Ltd,* above n 26, at [120].

will never incur the actual repair costs incurred to trigger any right to indemnity above "present day value" as the clear proviso clause in the policy requires.

[113] Whether or not election has occurred in each case is entirely fact specific.

[114] In the present case, it does seem that Tower, has not, in making the various offers, specifically mentioned that these offers were made without prejudice to their right to reinstate.

[115] Nevertheless, and turning to the facts which are before the Court, in my view, it is not possible to conclude here that there has been an unqualified election made by Tower in terms of the policy. Although there had been a long history of communications between the parties, as I see it, nowhere in these dealings has there been unequivocal notice given to Skyward that Tower intends to exercise its option in a particular way in terms of the policy. There is no doubt, and it has been acknowledged, that on more than one occasion, Tower has made extra-contractual offers to settle Skyward's claim by payment of a certain sum of money.

[116] But, I am satisfied in all the circumstances that in the emails in question and in the related correspondence, all that Tower was doing was simply making a cash-settlement offer to Skyward to settle its claim under the policy, with the amount calculated by reference to particular repair estimates at the time. This was in the context of the red zone having been declared. In these unique circumstances, I accept the argument of Mr Stewart QC that with these offers Tower was, in effect, offering to waive the strict requirement in the policy that actual costs of repair or reinstatement had to be incurred by Skyward before payment above "present day value" was made. It is clear too from all the material before the Court that unlike other customers of Tower, Skyward did not accept Tower's offer of settlement on this basis.

[117] As the decision in *Cape York* notes, a party purporting to make an election under a policy can only make a choice between the suite of options available to it under that contract. The offer made by Tower here, as I see it, was not the choice of a direct option under the policy and, as such, simply could not have constituted an

election. Looked at in this way, the offer from Tower might be seen here simply as part of settlement manoeuvring, which could not amount to an election to pay or reinstate under the policy.

[118] And, in any event, even if the house was capable of repair on its present site, as I have noted, Skyward could never incur the actual repair costs required to trigger a right to indemnity above "present day value" here. This is because, even though Skyward accepted at [47] of its statement of claim that the house was not economic to repair and could not be repaired, it had, in any event, put it beyond its power to repair by selling the Kingsford Street land to the Crown.

[119] Finally, as to the waiver and estoppel arguments Mr Sullivan endeavoured to raise before me, they do not appear in any way to be pleaded in Skyward's statement of claim, nor were they specifically part of the election or other questions to be answered here. Mr Stewart, for Tower, objected to Mr Sullivan's attempt to raise them at the hearing and I accept that they were not part of the issues to be determined by me. As such, I leave those questions to one side.

[120] For all the reasons outlined above, I would answer the third question posed at [76] above, "no". In this case, by the noted emails or otherwise, I find that Tower did not make an irrevocable election to settle Skyward's claim by making payment based on the full replacement value.

Result

[121] This decision determines the three questions that are before the Court as follows:

(a) As to Question 1, which asks under the terms of the insurance policy, on what basis is the amount payable by Tower to be calculated if a customer's claim is to be settled by Tower paying the cost of buying another house, the answer is:

The amount is to be the fair price of a replacement house which is to a reasonable and practical extent comparable, of the same 207m^2 size

and construction (as far as may be possible), in the same condition, and of the same style and extent (more or less) as the Kingsford Street house was when new.

(b) As to part (i) of Question 2, which asks under the terms of the insurance policy, is it Tower's choice whether the claim is to be settled by Tower paying the cost of buying another house, the answer is:

Yes – it is Tower who has the relevant election under the policy.

(c) As to part (ii) of Question 2, which asks under the terms of the insurance policy, is it Tower's choice if settlement by Tower making payment is chosen, whether the payment is to be based on the cost of rebuilding the insured house, replacing the insured house, or repairing the insured house, the answer is:

Yes – it is Tower's choice whether that payment is to be made based on a fair and reasonable assessment of rebuilding, repairing or replacement cost.

(d) As to Question 3, which asks whether in this case, by its emails of 9 September 2011, 29 November 2011, and 8 March 2012, did Tower make an irrevocable election to settle Skyward's claim by making payment based on the full replacement value, the answer is:

No.

It is hoped that these answers to these interpretation questions and the factual question might assist in resolving or narrowing remaining issues, including those of quantum, between the parties. That remains to be seen however.

[122] Leave is reserved therefore for either party on seven days notice to approach the Court if any further clarification of my decision or any aspects of it may be necessary or required.

Costs

[123] Costs are reserved. No submissions on costs were advanced by counsel before me. If costs are in issue and the parties are unable to resolve that question between them, then they may file memoranda on costs (sequentially) and, in the absence of either party indicating they wish to be heard on the matter, I will decide the question of costs based on the memoranda filed and the material then before the Court.

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D Gendall J

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