IN THE HIGH COURT OF NEW ZEALAND
CHRISTCHURCH REGISTRY

CIV-2015-409-000230
[2017] NZHC 251

BETWEEN	PAUL GEOFFREY MYALL Plaintiff
AND	TOWER INSURANCE LIMITED Defendant

Hearing: 5-7 December 2016

Appearances: S P Rennie and A G M Whalan for Plaintiff
M C Harris and S S McMullan for Defendant

Judgment: 23 February 2017

JUDGMENT OF DUNNINGHAM J

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[1] Residential homes do not come much grander than "Riverlaw". The original wood and sod house built in 1852 was subsumed within an imposing three storey triple brick mansion which was built in stages between 1885 and 1905. The homestead continued to be enlarged and developed by subsequent owners and, in 1984, was registered with the Historic Places Trust as a historic place.

[2] Mr Myall, a successful businessman, bought Riverlaw in 2003. On purchasing the historic eight bedroom six bathroom home, he embarked on an extensive programme to renovate and refurbish it. In late 2004, he telephoned Tower Insurance Limited, the defendant, and arranged for Tower to insure his newly refurbished home. Mr Myall's home was duly covered by Tower's "Super Maxi Cover" policy, which is a full replacement policy.

[3] There is now no dispute that cover under the policy was engaged when the homestead was damaged beyond repair in the 2010-2011 Canterbury earthquake sequence. However, the parties are not agreed on the amount which constitutes full

replacement value under the policy and are still around $2,000,000 apart. Mr Myall has brought these proceedings seeking a declaration that Tower is obligated to pay him the balance that he says is still owing under the policy.

[4] The key issues to resolve are either disputes over the interpretation of the policy, or disputes of fact or opinion regarding the quantification of costs. These disputes fall into three main areas:

(a) Do Tower's choices of building materials and construction methods comply with its obligations under the policy, particularly given the heritage qualities of this home?

(b) Are Tower's cost allowances for matters such as preliminary and general costs, contractor's margins, professional fees, and contingencies appropriate? and

(c) Was Tower was wrong to simply pro rata the costs of replacing the house to reflect the fact that it insured on the basis of a 650 square metre house when, in fact, Riverlaw was 799 square metres in area?

Background

[5] On 31 December 2004, Mr Myall telephoned Tower to arrange insurance for Riverlaw. Tower retained a record of the discussion which took place prior to the insurance cover being offered. In the call Mr Myall explained that the property was a "stately home" with eight bedrooms and six bathrooms, situated on just under two acres of "beautiful parklands". He said he had spent $600,000 renovating the heritage property and the work included employing a tradesman for 12 months just to restore all the woodwork. The property had been rewired, re-plumbed, and relined in areas which were not wood panelled. Mr Myall had spent $100,000 on the kitchen alone, and had had a structural engineer authorise that the property was all in good and sound condition.

[6] In providing information to Tower in order for Tower to calculate the insurance premium, Mr Myall advised that the floor area of the house was 650 square metres. It transpired that the house was considerably larger than that, with the expert quantity surveyors now agreeing on an area of 799 square metres. However, the floor area of 650 square metres was used by Tower in calculating the insurance premium.

[7] Tower suggested its Super Maxi Protection Policy and explained that the policy "gives you full replacement on the house … which means we will rebuild it up to a brand new condition if anything happens to it". Mr Myall agreed to take out insurance cover with Tower and the terms of the contract of insurance were contained in a document titled "Provider (Super Maxi Protection) Policy".

[8] Cover under the policy commenced on 31 December 2004 and was renewed each year on the anniversary of the policy being taken out. When the 4 September 2010 earthquake occurred, Mr Myall lodged a claim with Tower. At that stage it was not clear whether the home was repairable or whether it would be a total loss.

[9] Tower did not accept the claim straight away and advised that it wished to interview Mr Myall. This proved difficult to organise because Mr Myall spent considerable periods of time living overseas. Little progress had been made on the claim when the 22 February 2011 earthquake occurred. Both sides engaged engineers and, on 13 April 2011, Mr Myall's engineers, O'Loughlin Taylor and Spence, released a structural inspection report which advised that it was not feasible to repair the building and that it was unsafe to enter.

[10] By May 2011, Mr Myall was extremely dissatisfied with the fact that Tower had not yet confirmed that it would cover the damage. Proceedings were threatened, with Mr Myall's lawyers asserting that Tower had breached its good faith obligations by failing to respond to Mr Myall's claim within a reasonable time. However, on 17 June, Tower's lawyers informed Mr Myall that his claim had been accepted by Tower and that Tower was obtaining a costing to rebuild Mr Myall's house. It

warned that such costings would take longer than normal because "Riverlaw is a large historic house and will require considerable cost evaluation".

[11] By 10 October 2011, the quantity surveyors for Tower, Eggleton Group Limited (EGL), provided a replacement cost report. Mr Eggleton reported that he had worked out from the house plans that the gross floor area was larger than the 650 square metres recorded by Tower. He calculated it was 791 square metres. He estimated the replacement cost of the house as $3,025,000 plus GST. This excluded the cost of reinstating the hard landscaping, fountain and fencing, which he said would add approximately $300,000 to the cost. He noted that the main difficulty with providing "like for like" was that the ceilings were of pressed metal and these were not available. As an alternative, he allowed for plaster ceilings with ornate cornices.

[12] On 31 January 2012, Tower paid $1,359,000 as an interim payment.

[13] By the middle of 2012, the house was demolished in compliance with a demolition order issued by the Christchurch Earthquake Recovery Authority. In August, Tower wrote to Mr Myall's lawyers saying it now wished to settle and required a discharge to be signed within 10 working days. At that point Tower assessed the balance due to Mr Myall as $1,612,644.12. This sum was based on the EGL rebuild costs, less the EQC liability of $230,000 on the two events, the interim payment made by Tower to date, and the policy excess of $2,000, being $1,000 for each of the two earthquake events. That offer was rejected by Mr Myall in early 2013. Tower nevertheless paid $1,612,644.12 to Mr Myall in April 2012.

[14] It was not until May 2014 that Mr Myall's quantity surveyor, Mr Stuart Harrison of Harrisons Quantity Surveyors, provided his costings to rebuild Riverlaw. That estimate was $8,104,378 to rebuild a 770 square metre house. As Mr Harrison explained in his covering letter, on a comparative basis to the EGL estimate,[1] the replacement cost was around $6,000,000 plus GST.

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[1] That is, adjusted to reflect the lesser floor area.

[15] Mr Harrison's costings were sent to Tower by Mr Myall's lawyers on 28 May 2014, with a request that Tower give this matter "their earliest attention" and asking for a "considered response within 10 working days". That did not eventuate. However, on 16 June 2014, Tower wrote to Mr Myall's lawyers requesting further information, including copies of all documents and other information which had been provided to Mr Harrison, or which Mr Harrison relied on in preparing his rebuild cost estimate. Those documents, in three bound volumes, were sent to Tower in July 2014.

[16] Exchanges of correspondence continued between Tower and Mr Myall's lawyers. On 8 April 2015, Mr Myall's lawyers sent an amended replacement cost estimate from Mr Harrison of $8,820,619 and asked how that costing should be adjusted for the incorrect floor area recorded in the insurance policy, as Mr Myall's lawyers did not think "a straight averaging can apply". Shortly afterwards these proceedings issued.

[17] In late September 2015, Mr Harrison provided a third costing based on an 800 square metre house which was slightly lower at $7,843,791. A month later Mr Eggleton's second costing of $4,930,939 plus GST was provided.

[18] Despite expert conferencing, most of the differences between the two quantity surveyors' costings have not been resolved. They have been able to agree on some factual assumptions, including that the gross floor area of the house is 799 square metres. However, their estimate of the replacement costs still differs by more than $2,000,000. In their report produced following conferencing, they explained that they could not agree on the following:

(a) the construction methodology of the exterior and interior structural walls of the house;

(b) the construction methodology of the structural elements of the roof framing;

(c) the quantum and rates of many parts of each other's estimates;

(d) the contractor's margin;

(e) the contingency sum;

(f) the professional fees;

(g) the cost of contract works insurance.

[19] They explained that the areas of disagreement stemmed from:

(a) each adopting a differing construction methodology;

(b) each adopting a different interpretation of the policy and, in particular, the meaning of key clauses relating to what full replacement value means;

(c) the fact they had not adopted a common format for each estimate; and

(d) their differing professional views on the percentages/costs to be applied for:

(i) the contractor's margin;

(ii) professional fees;

(iii) the contingency sum;

(iv) local authority fees; and

(v) insurance.

[20] The significant difference between the quantity surveyors estimates has not been able to be resolved. Mr Myall still seeks payment of $3,717,449.79, being the

balance he says Tower is obliged to pay him to meet its obligations under the policy document to allow him to replace his home.[2]

What are Tower's obligations under the policy when costing the rebuild of this heritage property?

[21] The first category of differences between the parties related to whether decisions by Tower to substitute modern, and cheaper, specifications for certain aspects of the rebuild accords with the terms of the policy, when Mr Myall considers Tower's primary obligation was to rebuild the home as far as possible to the original specifications.

[22] The starting point is, of course, the terms of the policy itself. Both parties focus on the definition of 'full replacement value' and the explanation and qualifications to that term contained in the policy document.

[23] The same policy was considered by the Supreme Court in *Tower Insurance Limited v Skyward Aviation 2008 Ltd*.[3] The Court described the policy as follows:[4]

> The insurance policy is for full replacement value and proceeds on the basis of replacement on a new for old basis. The availability of such policies reflects a recognition that a traditional indemnity value policy may not provide sufficient funds to enable a damaged building to be repaired or rebuilt given that such exercises will require new materials in compliance with current building standards which may be more stringent that those in place when the building was constructed. A replacement value policy thus covers the impact of depreciation and increased building costs.

[24] The critical provision in the policy is Tower's promise to pay the "full replacement value" of the house when it suffers sudden and unforeseen accidental physical loss or damage.

[25] Full replacement value is defined in the policy as:

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2 It became clear during the hearing that Mr Myall is no longer planning to rebuild, but rather to replace the home, by purchasing an alternative property. Nothing appears to turn on this as the parties were agreed they were simply trying to quantify the sum which represented full replacement value.

3 *Tower Insurance Limited v Skyward Aviation 2008 Ltd* [2014] NZSC 185, [2015] 1 NZLR 341.

4 At [24].

> … 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 buildings, with no limit to the sum insured.

[26] While this is the "primary obligation",[5] the policy contains various explanations and qualifications to that obligation. First, the policy provides that "in all cases: … we will use building materials and construction methods commonly used at the time of loss or damage".

The policy also goes on to say:

> We are not bound to:
>
> - Repair or reinstate your house, contents or personal effects exactly to their previous condition;
>
> - Pay the cost of replacement or repair beyond what is reasonable, practical or comparable with the original;

[27] Many of the matters at issue between the parties turn on the application of these policy terms to the calculation of full replacement value for Mr Myall's house. They take on a particular significance where, as here, the insured property is a distinctive heritage home containing many features which are rarely, if ever, incorporated into a modern dwelling.

The plaintiff's approach to the policy

[28] Mr Myall put particular emphasis on the requirement for Tower to pay the full replacement, defined as being "the costs actually incurred to rebuild, replace or repair your house to the same condition and extent as when new …". He relied on the distinction made between an obligation to restore to "as new" and to restore to the condition "when new". Mr Myall cited *Colinvaux's Law of Insurance in New Zealand*, which says that "as new" refers to equivalence to the original condition, whereas "when new" refers to the original condition itself.[6] Mr Rennie argued that the phrase "as when new" denotes an obligation to return the building to its original condition, including all its components, according to the specifications

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5 *Skyward Aviation*, above n 3, at [42].

6 Robert Merkin & Chris Nicoll (eds) *Colinvaux's Law of Insurance in New Zealand* (Thomson Reuters, Wellington, 2014) at [8.5.2].

used when built. The plaintiff considered that objective was supported by the references later in the policy to "the same specifications" (or higher specifications where that is required by current laws) and to the house's "original" condition in the provision which says the insurer is not required to pay the cost of replacement or repair beyond "what is reasonable, practical or comparable with the original".

[29] Mr Myall says that because the insurer knew this was a heritage building, it took on the risk of achieving the original condition, even though that would involve skilled trades people (for example in iron masonry, iron tracery and stained glass) and higher costs. In keeping with that submission, he says that the statement that Tower would use "building materials and construction methods commonly used at the time of loss or damage" did not convert the primary obligation of restoring the original building into one of simply replicating it with modern materials. The reference to "common use" in this provision should be understood to mean materials and methods which are commonly employed in achieving the original condition and extent. As Riverlaw had just been fully restored using skilled trades people and, in many cases, original building and finishing techniques, Mr Myall had demonstrated that such materials and methods were commonly employed in achieving the original condition and extent of the house.

[30] In addressing the term of the policy which stated that Tower was "not bound to repair or reinstate your house … exactly to [its] previous condition" Mr Myall argued that he was entitled to have this clause interpreted on a *contra proferentem* basis. It should only be relied on where it was not possible to perform the primary obligation of rebuilding to the "same condition and extent".

[31] Similarly, Mr Myall argued that the provision which said that Tower was not bound to "pay the cost of replacement or repair beyond what is reasonable, practical or comparable with the original" should be read in the context of this being a full replacement policy for a heritage home. It did not allow Tower to make the substitutions in the specifications that it proposes because:

(a) a material damage policy takes as its subject matter a particular property with all its features;[7]

(b) reasonableness and practicality is to be judged with reference to the original condition and the background, and in a way that does not diminish the primary obligation to pay the full replacement value;[8]

[32] In this case, Mr Myall says that Tower accepted the risk of insuring a heritage home, and reasonableness should be determined with reference to the matters discussed and assumed prior to the contract. A cost is "reasonable" if it is within the expectation of the parties, objectively ascertained. It is "practical" if the element can be procured.

[33] To reinforce this point, Mr Myall relied on *Spina & Spina v Mutual Acceptance (Insurance) Ltd*, where the insurer's promise was to replace to a "condition equal to but not better or more extensive than the condition when new".[9] The insurer suggested that the internal walls of the 1930s era house could be more cheaply constructed out of gyprock, but the Court held that tongue and groove timber was more consistent with the architectural style of the building and was what was originally used. Because it was not so rare as to be difficult to procure, it would "not be extravagant or unreasonable" to require the insurer to pay for that cost.[10]

[34] In the present case, there are a number of areas where the two parties differ in their costings because the insurer considers it is entitled to depart from the original specifications and to propose a cheaper substitute. The areas are:

(a) *Ceilings* – Mr Myall's surveyor has costed the reinstatement of pressed zinc ceiling panels, as was in the original home, whereas Tower wishes to use a plaster finish;

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7 *QBE Insurance (International) Ltd v Wild South Holdings Ltd* [2014] NZCA 447, [2015] 2 NZLR 24 at [97].

8 *Skyward Aviation*, above n 3, at [42].

9 *Spina & Spina v Mutual Acceptance (Insurance) Ltd* (1983) 3 ANZ Insurance Cases 60-554, at 78,345.

10 At 78,345.

(b) *Timber surfaces* – Mr Myall wishes to have waxed timber surfaces, as they were previously waxed, whereas Tower says that a polyurethane finish is how such woodwork is commonly finished these days;

(c) *Exterior walls* – Mr Myall wishes to use structural concrete block work with a brick veneer where originally triple and double brick work was used. Tower wishes to use a timer frame and brick veneer on the first and second floors which will be thinner than the original walls;

(d) *Chimneys* – Mr Myall wishes to replace these with engineered chimney structures consisting of steel, block, and brick where visible, whereas Tower has costed replacement of the chimneys with a lightweight chimney structure designed to replicate the look of the brick chimneys;

(e) *Interior structural walls* – Mr Myall wishes to replace the interior brick walls with structural concrete block work, timber batons and gib board to both sides where originally brickwork and lath and plaster was used. Tower wishes to replace the internal walls with standard timber framed walls lined with gib board.

[35] While Tower does not suggest that Mr Myall gets a "modern" house replacement for what he lost, it says that the policy limits the extent to which he can claim the higher cost of materials and methodologies that are no longer in common use, or insist on original specifications when they are not required to produce a house of equivalent functionality and appearance. For this reason, Tower argues that the variations to the original specifications it proposes are consistent with its obligations under the policy.

Discussion

[36] The approach to construction of this insurance contract was not contentious. As the Supreme Court said in *Firm PI 1 Ltd v Zurich Australian Insurance*, the approach is an objective one with the aim being to ascertain the meaning which the

document would convey to a reasonable person having all the background knowledge reasonably available to the parties at the time of the contract.[11] The Supreme Court also said that:[12]

> While context is a necessary element of the interpretative process and the focus is on interpreting the document rather than particular words, the text remains centrally important. If the language at issue, construed in the context of the contract as a whole, has an ordinary and natural meaning, that will be a powerful, albeit not conclusive, indicator of what the parties meant.

[37] As was noted at the outset, the primary obligation is to meet the cost of rebuilding the house "to the same condition and extent as when new". Despite the plaintiff's submissions, I consider that on a plain reading, these words allow some tolerance from a requirement to build the house to the exact specifications as when new. The word "extent" clearly means a house built to the same size, and providing the same facilities, as the original. The word "condition" imports both the state of being "as new", and the quality of the building at the time it was new. In my view, the primary obligation allows some tolerance from building something which is identical to the original building, because it only requires Tower to achieve the "extent and condition" of the house when new, rather than to rebuild to "as when new". As a consequence, the wording of the primary obligation in the policy imports the notion of rebuilding something which is equal to, but not necessarily identical to, the original building. For this reason, I consider that the approach used in *Colonial Mutual General Insurance Co Ltd v D'Aloia*,[13] which was discussed by Dobson J in *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd*,[14] is of assistance.

[38] The policy in *D'Aloia* required the insurer to pay the cost of reinstatement of the building "… in a condition equal to but not better or more extensive than their condition when new". The Court considered the words "equal to" meant that:[15]

> the reinstatement does not necessarily have to conform precisely in appearance, structure and configuration to the destroyed building. But basically there must be "equality" in the sense of size, structural quality, amenities, space, plumbing, electrical, gas and like installations.

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11 *Firm PI 1 Ltd v Zurich Australian Insurance* [2014] NZSC 147, [2015] 1 NZLR 432 at [60].
12 At [63].
13 *Colonial Mutual General Insurance Co Ltd v D'Aloia* [1989] VR 161 (VSC).
14 *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd* [2012] NZHC 3344.
15 At 167.

[39] Applying that approach, Dobson J held that the insurer's obligation under the policy to "repair or rebuild your house to an 'as new' condition", was:[16]

> … not an absolute one to pay for replacement of the existing structure. The primary constraint on that obligation is that the insurer is obliged to pay for building materials and construction methods that are in common use at the time of the rebuilding. … Adopting the approach to equivalence in the full Court decision in *D'Aloia* it would be measured by size, functionality, relative quality and reasonably addressing the recreation of character and appearance.

[40] Similarly, I consider Tower's primary obligation in this case is to pay for a house of equivalent size, functionality and quality and which reasonably recreates the character and appearance of the original. The latitude afforded to Tower to deviate, where reasonable, from the original specifications is reinforced by the other express terms of the policy.[17]

[41] The policy in *Turvey* also allowed the insurer to use materials or construction methods that were "in common use". Dobson J explained that the purpose of the provision was to ensure:[18]

> That the insurer would not be liable for rare materials or outdated construction methods that would now be substantially more expensive in relative terms than more recently introduced methods or materials.

[42] However, he considered that being in "common use" did not require "the materials or methods to be used in, for instance, any particular proportion of house building nationally or in the locality of the insured property" and was:[19]

> Likely to be made out at a relatively low threshold [if] the materials are reasonably available, and their use (rather than any more commonly used equivalent) is warranted because of some aspect of appearance or functionality that was distinctive of their use in the original house.

[43] In my view, the same principles can be applied in Mr Myall's case. While the original plans and specifications are a logical starting point for building a home which is of the "same condition and extent as new", the policy expressly avoids the requirement for it to be identical to the original. Where the original specifications

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16 At [24].
17 Set out in [27] above.
18 At [25].
19 At [25].

are not able to be used, or are significantly more costly or difficult to use than a modern equivalent, Tower has expressly reserved the right to use a modern substitute if that achieves an equivalent outcome. In each case, it is a question of fact whether what Tower proposes complies with the policy obligation by recreating the original homestead in size, functionality, relative quality and aesthetic appearance, while not obligating it to incur unreasonable costs in doing so.

[44] I apply those principles to each of the disputed area of specifications.

Pressed zinc ceilings

[45] The first issue is whether the rebuild should be costed on the basis that pressed zinc ceiling panels are used in rooms that originally had these. Initially Mr Eggleton did not consider these were available so substituted plaster glass ceilings with "ornate cornices" in his costings.

[46] It is now common ground that pressed zinc ceilings are available. From the evidence supplied, including the photographs, the zinc ceilings are a distinctive decorative feature of the reception rooms where they are used, reflecting the grandeur of the homestead when these rooms were constructed. I do not consider that a plaster ceiling would be an adequate substitute, because it would not achieve the same, or equivalent, aesthetic qualities as the original ceiling. I therefore consider that the costing should be based on the use of pressed zinc ceiling panels in those rooms where they were originally installed.

Waxed timber surfaces

[47] There was a dispute over whether the internal timber surfaces should be waxed, which was the existing finish of the woodwork at least in some areas of the house, or should be a polyurethane finish as proposed by Tower. This turned on the interpretation of the provision allowing Tower to use building materials and construction methods commonly used at the time of loss or damage.

[48] Mr Myall argued that because he had employed a tradesman to wax some of the timber surfaces during the renovation process, this was an available method and,

given his understanding that the insurer was obliged to rebuild as far as possible to the original specifications, there was no basis for the insurer to substitute polyurethane for wax.

[49] While I accept that the threshold for "common use" is not high, I am neither satisfied that waxing is a building finish in common use, nor that the use of polyurethane would not produce an equivalent aesthetic finish. The onus is on Mr Myall to demonstrate that the finish proposed by the insurer would not achieve the equivalence of condition and extent that is fundamental to the policy. Given that waxing the timber was estimated to cost approximately twice as much as finishing it in polyurethane, I consider the insurer is entitled to use this common method in the absence of any evidence that it would leave the house in an inferior condition to the original.

Exterior and interior wall construction

[50] An obvious feature of the house when looking at the plans was the substantial thickness of the exterior, and many of the interior, walls. This was due to the use of triple and double brick work. Mr Harrison's costing assumed the use of structural concrete block work with brick veneer for all exterior walls, whereas Mr Eggleton proposes that the exterior walls on the first and second floors be constructed using a timber frame with a brick veneer. For the interior brick walls Mr Harrison's costing assumes they will be replaced with structural concrete block work, timber batons and gib board to both sides where originally brick work and lath and plaster was used. Mr Eggleton's costing was based on replacing such walls with timber framed walls lined with gib board.

[51] Mr Harrison's rationale for pricing concrete block and brick veneer for the exterior of the upper two levels and concrete block to the rebuild the internal brick was that this is:

(a) nearer to the original condition of the building; and

(b) the alternative proposed by Mr Eggleton might lead to a loss of thermal and acoustic benefits.

[52] The parties accept that modern building regulations mean that the original specifications of double and triple brick walls could not be used so an alternative construction method must be chosen. Both parties' options will have the same external appearance because both employ brick veneer. The issue is whether Tower's choice of modern construction method complies with its policy obligation to build to the same condition and extent as new. Mr Myall's main contention is that the use of timber framing might have inferior thermal or acoustic qualities than the original building. Thus he argues that it breaches Tower's policy obligation to build to the same condition as when new.

[53] Tower's costings include thermal insulation in exterior walls and acoustic insulation on the interior walls. Mr Harrison agreed he could not say whether Tower's proposed construction method would lead to a loss of acoustic and thermal benefits. Mr Eggleton also explained that his lighter walls would require a less expensive foundation than Mr Harrison's proposal. The potential visual difference in thickness was raised for the first time in cross-examination. Mr Eggleton accepted that the walls would not be as thick as the original walls and that might be noticed when standing under a door arch, but otherwise there would be no functional difference between the two options. I therefore have no evidential basis on which to conclude that the insurer's option would result in a house of lesser condition (whether structurally, functionally or aesthetically) than the original house.

[54] In my view, the defendant has not demonstrated that the structure proposed for the upper exterior walls, and for the interior walls, would be inferior in terms of function or aesthetics to the walls in the house when originally built. Given that the combined additional cost of constructing the exterior and interior structural walls and partitions to Mr Harrison's specifications was $153,222,[20] and would lead to a more costly foundation structure and would affect other costs which are calculated on a percentage basis, I consider this cost difference was not warranted. Tower can therefore rely on Mr Eggleton's specifications for the construction of the walls.

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[20] All costs differences given in this judgment from hereon are GST inclusive figures, unless stated.

Chimneys

[55] Mr Myall's quantity surveyor has costed replacing the existing heavy brick chimneys and open fire places with "engineered structures consisting of steel, block and brick". Such chimneys would not simply replicate the look of the original chimneys but also their function. Tower, on the other hand, has costed a lightweight replica structure, on the basis this reasonably satisfied the policy because the chimney can no longer lawfully be used for its original purpose and the house had an expensive computer controlled heating system. The difference in cost is approximately $180,000. Mr Harrison accepts that if functionality is not required, a cheaper chimney could be constructed.

[56] This particular issue brings into play the insurer's right to only pay the cost of replacement or repair up to what is reasonable, practical or comparable with the original. It was acknowledged that there was no functional requirement for the chimneys, both because of regional council rules prohibiting the use of open fires, and because the homestead had an alternative heating system which was accounted for in calculating the replacement value. Therefore, the only function of the chimneys was aesthetic as they comprise part of the visual impression of a stately home.

[57] In these circumstances, I do not consider it reasonable to require the insurer to recreate an entirely redundant chimney system at significantly greater cost than a lightweight replica chimney structure. I consider that the policy allows the insurer to make such a judgment. Again, on this issue, the insurer's costing prevails over that of the insured.

Has Tower correctly allowed for all replacement value cost in EGL's latest costing?

[58] The second category of differences between Mr Eggleton's and Mr Harrison's costings were not related to their understanding of how the policy should be interpreted and applied, but were differences between their assessments of costs for various items.

[59] Regrettably, for many of these items, it was difficult to compare the two experts' costs, or to understand the reasons for them being different. It would have been helpful if the experts had made greater effort in conferencing to align their cost schedules to make it easier to draw comparisons between their costs. As it was, some aspects of the costings required detailed explanation from the experts as to where the components of one party's costings could be found in the schedule of costings prepared by the other.

[60] Furthermore, the experts had not always identified where and how their costs differed, so it was difficult to ascertain whether there was in fact an error in the assumptions made by one expert, or whether the differences were simply differences of opinion. In general, I assessed both experts to be experienced and competent quantity surveyors, who gave their genuinely held opinion based on their understanding of what was to be rebuilt. On many points therefore, the case has simply turned on whether Mr Myall has been able to discharge the onus on him to demonstrate that Tower's costing was wrong, or that his should be preferred. Where that onus was not discharged, I have found in favour of Tower.

[61] In light of those preliminary comments, I now deal with each of the cost allowance disputes raised by the parties.

Tiling

[62] Mr Harrison's tiling allowance is $111,412.00 higher than Mr Eggleton's. Mr Eggleton says he has based his costings on exactly the same area of tiles as Mr Harrison. He assumed the use of the same tiles as were imported by Mr Myall for the renovation, or an equivalent tile where he did not have information about the cost of the tiles that Mr Myall had purchased. His tiling allowance was therefore based on the invoices for tiling costs that Mr Myall incurred in the course of his renovations, plus an assessment of labour costs and an inflation adjustment.[21] He considered that, even then, there was a considerable contingency factor in his calculations. He acknowledged that he had not made an enquiry of New Zealand

[21] Mr Harrison applied the labour rates previously charged to Mr Myall of $70 to $80 per square metre, as he believed they still reflected local rates.

suppliers for the cost of supplying the tiles but said that a retail shop in New Zealand would not stock these tiles.

[63] The only explanation Mr Harrison gave in response is that his costs were "all based on usual local rates". He did not identify where he took issue with Mr Eggleton's costings. I do not think that the plaintiff has discharged his onus to displace Tower's costings so Tower's costing for tiling can be used to calculate full replacement value.

Exterior windows and doors

[64] The expert witnesses were able to agree on the area of exterior windows and doors required. However, they could not agree on rates. Mr Harrison used a higher rate than Mr Eggleton, which resulted in a cost difference of $89,041.

[65] One of the difficulties in comparing each expert's costings for this aspect of the rebuild, was that Mr Harrison's costings for these items included the glazing, whereas Mr Eggleton listed glazing in a separate category, although, in the end, that did not appear to affect the identified price difference. Mr Eggleton explained that the rate he used, of $990 per square metre, came from another historic house project he was involved in, being Wansbrough House. He considered that the Wansbrough House windows were probably "more substantive", but he used the same rate for this rebuild.

[66] As Mr Eggleton has explained that the basis for his costings relate to an actual historic home project, and has used the same square area of exterior window and doors as Mr Harrison has, I am unable to identify why Mr Eggleton's costings should be rejected in favour of Mr Harrison's. Accordingly, I am satisfied that Tower's costings for this element is appropriate and can be used to calculate full replacement value.

Scaffolding

[67] Mr Harrison's costing for scaffolding assumes it will be required for 60 weeks. It also provides for four protection nets and mobile scaffolding sections

and allows for erection, dismantling and cartage costs, which are a one-off cost regardless of the duration for which scaffolding stands. His allowance of $241,362 is $68,862 more than Mr Eggleton's allowance of $172,500. He rejected the suggestion that, given the high scaffolding costs, a competent builder would tailor a construction programme to minimise those and to avoid having the entire building scaffolded over such a lengthy period. He said that did not make a lot of sense with this particular build because, for example, block work is built from the ground up rather than elevation by elevation. There was therefore, little scope for dismantling scaffolding and moving it to reduce hire costs and, in any event, the costs of erecting and dismantling it remain fixed.

[68] Given there was agreement that the entire rebuild project would take some 18 months, I consider the estimate of 60 weeks for the period during which building was to be scaffolded was realistic and I accept that, with a three storied house such as this, Mr Harrison is correct to assume there would be limited opportunity for only partially scaffolding the building and reducing the period of scaffolding hire. I therefore accept Mr Harrison's costing for scaffolding as more realistic and consider that it should be used to calculate full replacement value, instead of Mr Eggleton's.

Foundations

[69] The difference between the quantity surveyors' foundation costs was $67,358. The experts agreed on the scope of perimeter foundation required, but Mr Harrison had assumed that a gridage of central beams, all on grade, would be required. Mr Eggleton did not require this because of the lighter structure he proposed for the walls. Mr Harrison accepted that the difference in wall structures probably drove the difference in foundation price.

[70] There was no suggestion that the grid system within the foundation perimeter would be required if Mr Eggleton's lighter wall structures were adopted and I have already found that Tower was entitled to use that lighter wall structure for its costings. Accordingly, I consider Tower's estimate for the cost of foundations is appropriate and reflects the policy requirements.

Exterior works

[71] Mr Myall asserted that there was a range of exterior work required including hard paving, fencing, irrigation, lighting and replacement of black and white feature Victorian tiling. Mr Harrison's costing for this work is $508,480, whereas Mr Eggleton allows $379,500, a difference of $128,980.

[72] Mr Harrison's costings relied on a quote from the landscaping firm Morgan and Pollard to replace the hard paving and fencing, a quote from Ward Irrigation for replacement of the irrigation system, plus a provisional sum of $23,000 for lighting and $63,825 for replacing the black and white feature Victorian tiling.

[73] Mr Eggleton used the irrigation costing from Ward Irrigation but rejected the Morgan and Pollard quote, as well as Mr Harrison's allowance of $63,825 for the Victorian black and white tiling, because he considers these are well above a fair market rate. He also rejected any costs for exterior lighting, saying he had not seen evidence of such lighting, although Mr Myall's evidence was that when he carried out the restoration, the external hard landscaping included tiling, extensive garden lighting, irrigation, water features, two electronic gates and planting.

[74] Mr Eggleton's alternative cost does not appear to be based on an agreed scope of works nor does he provide a breakdown of his costings. While Mr Eggleton says he has "not seen evidence of $23,000 of exterior lighting" he does not say what extent of lighting he is satisfied was there.

[75] On this issue there was a surprising lack of detail from both parties. It is impossible to determine how Mr Eggleton has come up with his estimate of $300,000. Mr Harrison has, at least, based his estimate on quotations, although they were not supplied in evidence and it appeared there was a dispute over the extent of exterior lighting which needed replacing.

[76] Given this position, I can not be satisfied that Mr Eggleton's estimate of $300,000 for the exterior works is based on the work actually required, and therefore reflects a defensible estimate of fair replacement value under the policy terms. However, given the concerns Mr Eggleton expresses about the quotes Mr Harrison

relies on, I am also not prepared to adopt Mr Harrison's costing as accurate. This is an unsatisfactory situation. Had the parties at least agreed on a scope of works and provided comparative costings for each element, I could have made an informed assessment of the two estimates. However, that is not possible and I have inadequate evidence on which to decide whether either party's costing on this element meets Tower's obligation under the policy.

All other house differences

[77] There are a range of other components of the rebuild where the quantity surveyors differ on quantum and/or rates to be used. These include roofing, heating and ventilation, plumbing, pipework and hardware, and leadlights and stained glass for exterior windows and doors. Despite the differences amounting to $273,901, neither party sought to identify the complaints they had with the other party's costing. Mr Eggleton provided his costings and rates so Mr Harrison could have pointed to any disagreement he had with Mr Eggleton's methodology or the rates he had adopted. In the absence of any identified error in Mr Eggleton's costings for all these sundry matters, the plaintiff has not discharged the onus on him to show that it is wrong. Accordingly, Tower's costings on these components are upheld and can be used in calculating full replacement value.

Preliminary and general costs

[78] Preliminary and general costs encompass various costs which are directly related to the building project, but which are not been included in the materials, labour or overheads. For example, the costs of running a building site, organising the job and arranging for ordering materials, cutting off power, and ensuring rubbish skips are delivered and removed. Here there was a difference of $38,514. This appeared to relate to the difference in rebuild costs as both used an allowance of 7 per cent of the rebuild cost.

[79] In the scheme of the build project as a whole, the difference is modest and relates to the differences in assessment of the rebuild cost. No error in the approach Mr Eggleton has used is identified and, although the actual figure may have to change slightly as I have not accepted Tower's rebuild costings in their entirety, the

plaintiff has not established that Tower's method of assessing for preliminary and general costs is in error. Mr Eggleton's method of costing for preliminary and general is therefore upheld.

Contractor's margin

[80] Mr Eggleton has allowed a contractor's margin of 10 per cent, whereas Mr Harrison has allowed 12 per cent. Mr Harrison acknowledges that 10 per cent is a typical percentage for a "usual build". However, he considered that this is a significant rebuild of a heritage home requiring higher skills of the contractor so a higher percentage than usual is justified.

[81] Mr Eggleton, in contrast, says that because it is such an expensive build, a margin of 10 per cent would yield a profit (on his costings) of $448,525. Given a prestige project like this would be competitively tendered and up for negotiation, he considers that a 10 per cent margin would still be attractive for a suitably qualified and experienced contractor. He also says he is aware of numerous recent cases where margins of below 10 per cent have been accepted on larger and more complex projects.

[82] Both experts agreed that this project would be competitively tendered and the builder's margin would be up for negotiation. I therefore accept Mr Eggleton's professional view that a 10 per cent margin would still be sufficiently attractive for a competent contractor to accept.

[83] Given those findings I do not consider that Mr Eggleton's choice of a 10 per cent margin is wrong and this aspect of Tower's costings is upheld.

Professional fees

[84] Both quantity surveyors originally assessed the cost of professional fees using a percentage of 15 per cent. On Mr Harrison's higher costings this translated to an allowance of $927,349. However, Mr Eggleton revised his percentage approach and, in his final costing, reduced the allowance for professional fees saying that:

> Once the costs reach into seven figures, particularly above $2 million, using 'rule of thumb' percentages is not appropriate. The amount of work required of a professional like an engineer or an architect, and a fair fee for the professional, does not simply increase in lockstep with construction costs.

[85] Mr Eggleton therefore moved away from basing his allowance for professional fees on a flat percentage of construction costs. Instead, he assessed what he considered would be a reasonable allowance for the fees of each of the professionals that would be involved, including architectural, engineering, surveying and landscaping, which he calculated at $485,760.

[86] Mr Harrison, however, adhered to the use of percentages to quantify the cost of professional services for the project saying "it is traditional practice to use percentages for consultants". However, Mr Harrison did agree in the end that both his and Mr Eggleton's figures were "within a reasonable range". In my view, therefore, Mr Eggleton's quantification of the fees of the professionals has not been shown to be wrong or unreasonable, and its use in calculating full replacement value is upheld.[22]

Contingency fees

[87] Mr Harrison's allowance for contingencies, which he originally put at 5 per cent of the rebuild cost, was increased to 10 per cent in his final costing. Mr Eggleton's, which was 12 per cent in his original costing, was recalculated based on a contingency analysis for the categories of risk expected to arise when rebuilding this house, rather than using a flat percentage of total costs. Thus, while Mr Harrison's 10 per cent contingency amounted to $618,232, Mr Eggleton's was $255,300 which represented about 4.7 per cent of his calculated construction costs.

[88] Again Mr Eggleton's revised approach was justified by saying that the allowance for contingencies will not necessarily relate directly to the cost of the build. While 10 per cent may be appropriate for projects costing less than $1,000,000, above that it may be necessary to assess the risks of the particular project, which he has done. Mr Harrison takes issue with aspects of Mr Eggleton's

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[22] For the avoidance of doubt, I am referring to the total sum he arrives at, and not the percentage of construction costs that this reflects, which Mr Harrison worked out to be 9.8%.

risk analysis saying he disagrees with some of the categories of contingency and with the levels of risk assumed.

[89] In my view, Mr Eggleton has departed from a conventional contingency assessment because he is concerned that calculating it on a percentage basis results in a relatively significant allowance. However, using Mr Eggleton's approach, even on his costings, the allowance was less than 5 per cent and the percentage allowance would be even lower with my acceptance of some of Mr Harrison's costings. I do not consider that realistic for a one-off project such as this involving the rebuild of a large, complex home. I therefore accept that Mr Harrison's contingency allowance of 10 per cent of the cost of the rebuild should be adopted when calculating full replacement value.

Insurance costs

[90] The difference between the cost of contractors' all risk insurance is modest in the scheme of things, being $18,141. Mr Harrison uses a percentage of 0.75 per cent of the estimate based on advice from IAG. Mr Eggleton has used a percentage of 0.71 per cent, as he says the insurance market is "sufficiently competitive that I am satisfied my allowance is within a reasonable range". However, I had no evidence to support Mr Eggleton's assertion that the insurance market was competitive and, as Mr Harrison's is based on actual advice from an insurer, I accept that his 0.75 per cent allowance should be used in calculating full replacement value.

Is it open to Tower to adjust for the reduction in area of the house to pro rata the costs?

[91] The last disputed issue is whether Tower could adjust the costings to rebuild the 799 square metre house, to reflect the fact that Tower insured it on the basis it was 650 square metres in area, by using a pro rata adjustment.

The plaintiff's position

[92] Mr Myall says the costs cannot be adjusted on a pro rata basis because it does not reflect the fact that Tower understood it was insuring an eight bedroom, six bathroom home. Many of the costs will remain fixed whether the house is

650 square metres or 799 square metres and Tower should take this into account in adjusting the costs.

[93] Mr Myall's quantity surveyor, Mr Harrison, assessed the adjustment on the basis of utility. Before adjusting, he removed those areas which he considered would always be present, such as the number of bathrooms and toilets, and only adjusted costs that are affected by floor area such as ceiling and floors. This resulted in a higher adjusted cost than would be achieved by adjusting on a pro rata basis. Mr Myall argued that this approach was supported by the judgment in *D'Aloia*, where a pro rata approach to adjusting for a difference in size was rejected by the Victorian Supreme Court because it would fail to "give effect to the intensity of services within the smaller area".[23]

Tower's position

[94] Tower, however, says that the insurer has a discretion about how to deal with the under-insurance. Because it is a contractual discretion, the basic common law rule is that the Court does not substitute its own decision for that of the holder of the contractual power:[24]

> It is very well established that the circumstances in which a Court will interfere with the exercise by a party to a contract of a contractual discretion given to it by another party are extremely limited … These cases show that provided that the discretion is exercised honestly and in good faith for the purposes for which it was conferred, and provided also that it was a true exercise of discretion in the sense that it was not capricious or arbitrary or so outrageous in its defiance of reason that it can properly be categorised as perverse, the courts will not intervene.

[95] This approach to the exercise of a contractual power was confirmed by Mander J in *C and S Kelly Properties Ltd v EQC and Anor*.[25] While criticising some of Mr Harrison's adjustments for not being transparent, Tower primarily argues that the plaintiff was obligated to demonstrate that Tower's pro rata adjustment was unreasonable. It argues that this threshold has not been met as the plaintiff merely suggested another way to factor the adjustments.

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23 At [168].
24 *Ludgate Insurance Co Ltd v Citybank NA* [1998] Lloyd's Rep IR 221 (CA) at [35].
25 *C & S Kelly Properties Ltd v Earthquake Commission* [2015] NZHC 1690 at [66]-[74].

Discussion

[96] The starting point for determining how the adjustment is to be made is to consider what the policy was insuring. Each renewal certificate clearly stated that what was being insured was an owner occupier house, built in 1885, based on "area square metre 650". Details such as the number of rooms, including service rooms such as bathrooms and kitchens, were not specified in the policy and I do not consider Tower was contractually bound to rebuild the same number of rooms despite the under-insurance. The primary descriptor of the property was its square area and the premium was calculated on that basis.

[97] Consequently, I do not agree, as Mr Myall's quantity surveyor suggests, that Tower must put to one side costs that are "not affected by the floor area, such as the number of toilets, showers and doors or the kitchen, vanity units and the like". To do so suggests that the floor plan must be artificially shrunk, by approximately 20 per cent to accommodate the same number and size of doors, windows, walls, joinery, appliances, bathroom fittings and the like.[26]

[98] I consider that is an unrealistic scenario. Mr Myall contracted to insure a large stately home with the general characteristics of his home, but which was 20 per cent smaller than his house actually was. Realistically, such a home would have commensurately fewer bathrooms, bedrooms, and reception rooms and therefore proportionately fewer structures such as doors, walls and windows, fewer fittings, and less joinery, without its function being compromised. I therefore do not accept, Mr Harrison's costing which endeavoured to include the same number of rooms and fixtures and fittings in a house which was one fifth smaller than the actual house.

[99] I also do not consider *D'Aloia* relevant to the present case. In *D'Aloia*, the insured lost six flats in a fire. Five of the flats were not self-contained, but were serviced by a separate laundry and ablutions block which was also lost to the fire. To comply with current planning rules the flats could not be rebuilt in their existing configuration as they had to be fully self-contained. As a result, the new building

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[26] Being the pro rata difference between 650 and 799 square metres.

occupied a total floor area of 486 square metres rather than the original buildings' 264 square metres. The insurer was only obliged to construct something which was equal to, but not better or more extensive than, the existing. This led to a dispute over how much of the cost of the new building the insurer was obliged to pay for.

[100] The Court readily rejected the appropriateness of a pro rata approach to costs to reflect the difference between the original 264 square metres and the 486 square metres. They noted that such a reduction would fail to give effect to the intensity of services required within the smaller area.[27] However, in that case, a primary obligation of reinstatement was to provide six functioning flats regardless of area. That contrasts with the present case, where I do not consider there was an obligation to recreate all existing rooms (for example, six functional bathrooms), albeit within a 20 per cent smaller house.

[101] As in *D'Aloia*, I accept there will be many other situations where a pro rata adjustment for under-insurance would not be appropriate. For example, it would likely be inappropriate to pro rata the costs of building a 120 square metre house to reflect that the insurance policy provided for replacement of an 80 square metre house. In that situation significantly more of the costs would be for items that were not affected by floor area, such as provision of a bathroom and kitchen. More careful scrutiny of the costs would have to be made in adjusting for errors in insured floor area. However, here the house is very large, and many of the costings are based on the extent of work to be done, rather than fixed costs, so no obvious injustice will be done by adjusting as Tower proposes to do.

[102] For these reasons, and with this particular house, the appellant has failed to satisfy me that Tower's approach to adjusting the costs is wrong and I find in the insurer's favour on this aspect of the claim.

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27 *D'Aloia*, above n 13, at 168.

Summary of outcome

[103] Overall, Tower has been largely, but not entirely, successful in defending Mr Myall's claim that it has not honoured its policy obligation to pay full replacement value for his earthquake damaged home.

[104] In relation to the interpretation of the policy, I have generally accepted that the policy affords the flexibility claimed by Tower to substitute modern construction methods and materials where the original is no longer available, is no longer permitted, or is unreasonably expensive (albeit with the proviso that the substitute proposed ensures equivalence to the original condition of that element of the house). In this regard, the only item which I have held Tower should price on the basis of Mr Myall's proposed materials is the pressed zinc ceilings.

[105] In respect of the balance of disputes as to the costs allowance for aspects of the house and external works, I have dismissed all Mr Myall's claims that Tower is in breach of its obligation under the insurance policy, except:

(a) I have accepted Mr Harrison's allowance for scaffolding;

(b) I have accepted Mr Harrison's allowance for a contingency sum, being a sum which is 10 per cent of the house rebuild costs; and

(c) I have accepted that insurance costs should be calculated using 0.75 per cent of the rebuild costs not 0.71 per cent.

[106] I also consider that neither party has satisfied me that the costs for exterior works has been adequately scoped and then calculated. Leave is reserved to the parties to file further evidence on that issue and to seek the Court's further assistance in determining it, should they be unable to resolve it themselves.

[107] Finally, I have accepted that, in the particular circumstances of this case, Tower was entitled to adjust the calculated full replacement value of the 799 square metre house on a pro rata basis, to reflect the insured floor area of 650 square metres.

[108] Given there has been mixed success, it is not possible to make a declaration as to the precise monetary sum the plaintiff is entitled to be paid. Nevertheless, I expect the parties should be able to calculate it based on the findings in this judgment. Leave is reserved to both parties to seek any further relief required as a consequence of this judgment.

Costs

[109] Costs are reserved. Obviously Tower has been successful on the majority, although not all, of the issues. I expect costs should be able to be resolved between the parties on that basis. However, if the Court's assistance is required, the defendant is to file any memorandum seeking costs within 30 working days of the date of this judgment. Any memorandum in response is to be filed within 40 working days of this judgment.

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