IN THE COURT OF APPEAL OF NEW ZEALAND

CA60/2015
[2015] NZCA 250

BETWEEN	MEDICAL ASSURANCE SOCIETY OF NEW ZEALAND LTD Appellant
AND	MICHAEL CHARLES EAST, JANE LOUISE EAST AND INGRID ROBYN TAYLOR Respondents

Hearing:	1 May 2015
Court:	Harrison, Keane and Wylie JJ
Counsel:	M G Ring QC and A J Horne for Appellant N R Campbell QC and A G M Whalan for Respondents
Judgment:	17 June 2015 at 10.30 am

JUDGMENT OF THE COURT

A The appeal is allowed in part and the declaration made in the High Court that the policy does not require the cost of rebuilding or restoring the dwelling has to be incurred or about to be incurred before the appellant is liable to pay the replacement value is set aside.

B The appeal is otherwise dismissed.

C The cross-appeal is dismissed.

D The application for leave to adduce further evidence is dismissed.

E There is no order for costs.

REASONS OF THE COURT

(Given by Harrison J)

Introduction

[1] Two issues arise on this appeal from a judgment given in the High Court at Christchurch on a dispute between parties to a policy of insurance about the insurer's liability to indemnify following damage to a residential property in the February 2011 Christchurch earthquake.[1]

[2] The first issue is whether Whata J was correct to declare that the words "cover the cost of" rebuilding or restoring a dwelling, where used in the policy, oblige the insurer to pay to the insured party the cost of repairing damage irrespective of whether liability to incur those costs has been or will ever be incurred.

[3] The second issue is whether the Judge was correct to declare that the insurer's obligation to rebuild or restore the dwelling "to a condition substantially the same as new, so far as modern materials allow, and including any territorial costs which may be necessary to comply with any statutory requirements or Territorial Authority by-laws" requires that the dwelling be rebuilt or restored to the standard of a new dwelling built today.

[4] The insurer, Medical Assurance Society of New Zealand Ltd (MAS), appeals against both declarations. The insured parties, Michael and Jane East and Ingrid Taylor (who we will call the Easts), cross-appeal against what is said to be a separate decision by the Judge and also apply for leave to file fresh evidence.[2]

Facts

[5] The essential facts are not in dispute.

[6] The Easts own a 351 square metre dwelling on a property in Christchurch. The house was built in 2007 on a 100 mm concrete slab. It combines wood framing,

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1 *East v Medical Assurance Society New Zealand Ltd* [2014] NZHC 3399.

2 In particular, the cross-appeal is against three paragraphs in *East*, above n 1: [116], [117] and [119(c)].

masonry, brick veneer and plaster finishes and is of a high quality. The Easts insured the property with MAS under what is called its Goldshield policy.

[7] The house was damaged in the Christchurch earthquake on 22 February 2011. It has settled by a maximum of 44 mm and exhibits slope differentials of greater than 1:200 in certain places. While the parties agree that this damage must be repaired, they differ on the appropriate methodology and the scope of works reasonably required.

High Court

[8] In order to give context to MAS' appeal it is necessary to narrate briefly the history of this litigation with particular reference to the relief sought.

[9] In October 2014 the Easts applied to the High Court for a declaration of undefined breadth about the nature of MAS' liability and for judgment for the estimated cost of repairing the house of $3.096 million. It appears that the parties were subsequently able to settle issues for determination.

[10] Whata J heard the Easts' claim at a trial which occupied five days of evidence and submissions in November 2014. With commendable expedition he delivered judgment within a month. It must be noted that much of the judgment is a narrative of evidence relating to a dispute about the proper measure of MAS' liability. It is unnecessary for us to revisit that evidence or the Judge's findings on it because they are not in issue on appeal.

[11] In the event the Judge found for the Easts and made these findings or formal declarations, only the first and third of which are in issue:

(a) The policy does not require that the cost of rebuilding or restoring the dwelling has to be incurred or about to be incurred before MAS is liable to pay the replacement value.

(b) A specific engineering solution such as underpinning is necessary to restore the house to "substantially the same as new" in accordance with the Building Code requirements.

(c) The policy standard of rebuilding or restoring the dwelling to a condition substantially the same as new means in accordance with Building Code requirements as they exist at the time of the rebuild or restoration.

[12] The Judge reserved leave to the parties to apply for further orders finalising quantum after the local authority had considered whether it was prepared to grant consent to a particular type of re-levelling and notwithstanding the terms of the judgment. Costs were also reserved.

[13] It will be apparent from this brief summary that the Easts' claim for damages failed. As we shall explain more fully, their claim was based on a seriously flawed estimate for rebuilding costs of $3.096 million.[3] Moreover, the Judge allowed for the alternative contingency of a different engineering premise such as underpinning, with the inevitable prospect of another and different estimate being offered at a later date.[4]

[14] It is thus plain that despite the judgment the Easts' claim remains some distance away from settlement. Among other things, any rebuilding work will require a consent from the local authority, the Christchurch City Council.[5] Until the terms of its consent are fixed, the scope of restoration works will not be known and the parties will be unable to make progress towards settling rebuilding costs. The Judge appeared towards the end of his judgment to recognise that his construction of the policy reflected in the first declaration could prospectively give rise to problems in quantifying liability.[6]

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3 At [96(a)].
4 At [96(c)].
5 At [116].
6 At [117].

[15] In these circumstances it is unclear to us why the first declaration was ever required or made. Mr Ring QC for MAS referred us to evidence suggesting that the Easts were parties to a type of contingency arrangement with an American company which entitles it to 35 per cent of any amount payable in excess of a judgment for $1.4 million. While this issue is not directly relevant to our decision, it may explain the reason for the Easts' pursuit of the unusual course of seeking judgment for payment of restoration costs according to an estimate before they are even incurred.

Policy

[16] The relevant provisions of the policy are as follows:

> Our Undertaking
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> The Society undertakes that if, during any period for which the premium has been paid, any unintended and unforeseen physical loss or damage occurs or costs or losses arise which have been provided for by the Policy, its Schedule or any Renewal Advice, then the Society will compensate you in the manner and to the extent described.
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> …
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> Types of cover
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> A Dwelling
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> 1) **Dwelling – Replacement Value –** applies to permanently owner/occupied dwellings (ie, not tenanted or holiday homes) and, when selected, *means that the Society will cover the cost of rebuilding or restoring the dwelling to a condition substantially the same as new, so far as modern materials allow, and including any additional costs which may be necessary to comply with any statutory requirements or Territorial Authority by-laws.* There is no maximum sum insured but the liability of the Society shall not be greater than the reasonable cost to rebuild or restore the dwelling based on a floor area no greater than that declared in the proposal and specified in the Schedule.
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> 2) **Dwelling – Agreed Value –** applies to permanently owner/occupied dwellings (ie, not tenanted or holiday homes) and, when selected, means that the Society will cover the cost of rebuilding or restoring the dwelling as in 1 above but subject to the maximum sum insured stated in the schedule. This sum will be increased each year in accordance with building cost changes.
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> 3) **Holiday Home –** when selected is subject to Agreed Value conditions as in 2 above.

> In any case, *if you elect not to rebuild or restore the building we will make a cash settlement not exceeding the indemnity value as assessed by a qualified Valuer.*

(Emphasis added.)

Decision

First issue

[17] On the first or what counsel called the timing issue, the essence of the Judge's reasoning is as follows:

> [24] Nevertheless, the reference to "will cover the cost" does not obviously mean that MAS's obligation to pay is only triggered when the costs are actually incurred or just about to be incurred and subject to an incremental approval basis. Different words are needed to place such a strict and cumbersome fetter on the prima facie right to replacement value compensation. First, the objective of the policy is to compensate the Easts for their loss or costs; that is to hold them free from harm including the cost of repair. Second, the liability to compensate arises on the occurrence of a qualifying damaging event. Third, quantum of replacement value is not based on the incurred costs of the rebuild or restoration. Rather, the replacement value is to be objectively assessed. The claimed costs must be reasonable and they are based on the size of the home. Fourth, there is no mechanism in the policy providing for the incremental assessment and approval of costs by MAS. Fifth, and overall, there is nothing in the policy to alert the Easts that they will have their compensation fettered in that way.
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> …
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> [26] For the reasons already listed, I do not accept that the Easts could reasonably have expected to be burdened with an invoice by invoice approval procedure not provided for in the policy. The more obvious meaning of "cover the cost" in context is that MAS will pay the reasonable cost of the rebuild or restoration. This may present problems where there is disagreement (as here) about what is required to restore the building to an as new condition. … But that does not mean the parties default to [an] invoice by invoice approval system. Indeed such a system could lead to the situation where MAS refuses to approve a cost item leaving the Easts to either pay and or sue mid construction. As I say, express words were needed to alert the Easts to this potential outcome. Conversely, the Easts must reasonably have expected that they [be] will in a position to pay for the cost of a rebuild before it takes place.
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> [31] Accordingly, if the Easts elect replacement value cover, MAS is obliged to pay compensation provided the amount claimed is necessary to cover the reasonable cost to rebuild or restore the dwelling based on a floor area no greater than that declared in the proposal and specified in the

> Schedule. Liability to make payment is not conditional on the costs actually having been incurred.
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> (Footnotes omitted.)

[18] The Judge's reasoning falls for examination by reference to the operative or insuring provision of the policy. It is common ground that the policy obliges MAS to pay to the Easts the dwelling's "replacement value" being the cost of rebuilding or restoration subject to what is reasonable according to the specified floor area. The only issue arising on appeal on which both Messrs Ring QC and Campbell QC for the MAS and the Easts respectively advanced careful argument is one of timing and responsibility.

[19] We start our analysis by emphasising that on the occurrence of the insured fortuity of loss or damage to their property the Easts were entitled to exercise a right of election between two distinct courses. One was to rebuild or restore the house, as they have chosen to do here, whereby MAS assumed an obligation to cover the reasonable costs. The other was not to rebuild or restore the house, in which case MAS was obliged to "make a cash settlement" not exceeding indemnity value.

[20] In our judgment this difference in MAS' obligations is relevant. In the event of a decision not to restore, it is bound to pay an agreed amount of money, fixed according to the objective measure of indemnity value; in the event of a decision to restore, its obligation is to "cover" costs, which is necessarily something different. In the insurance context the word "cover" describes an insurer's agreement to secure an insured party against a loss. The composite phrase "will cover" expresses MAS' undertaking to provide sufficient funds to secure or indemnify the Easts against liability to pay the rebuilding costs when they are incurred. It is simply shorthand for the longer phrase: "indemnify the insured against".

[21] The difference in wording between this and other policies is immaterial. What is plain is that MAS' reinstatement clause reflects an insurer's orthodox obligation to indemnify against a liability where the insured party elects to rebuild, not to pay out money where the insured has not incurred and may never incur a liability to meet the cost of restoration. It agrees to cover the cost, not an estimate of

it, and the cost is not and will not be known until, at the least, liability to pay for the work is incurred.

[22] The declaration gives rise to a number of problems. First, it begs this question: if liability does not require the rebuilding costs to be incurred, on what basis is MAS obliged to pay? The Easts claim that an estimate is sufficient. But, as Mr Ring pointed out, the trial highlighted the untenability of that premise.

[23] The Easts claimed judgment for damages of $3.096 million based on a quantity surveyor's estimate. Under careful cross-examination by Mr Horne, the surveyor conceded that his figures contained significant errors.[7] In the event the Easts' counsel accepted the obvious – the cost estimates required reconsideration and quantum would have to be revisited.[8] There is evidence that the correct estimate is more likely to be in the order of $1.5 million. There is nothing in the policy to suggest that the parties intended MAS would be bound to settle with the Easts on such a problematic basis.

[24] The reason is obvious. By their nature, estimates are approximate and subject to change. To oblige an insurer to settle on an estimate would lead to constant difference and uncertainty. By contrast, contracts are for fixed prices subject only to variation according to agreed provisions. Once the insurer has approved the terms and conditions, which it normally negotiates for the insured party, within those terms and conditions its liability is absolute.

[25] Second, some of the Judge's reasoning about the mechanics of settlement,[9] identifying what are said to be problems with the insurer's agreement to pay according to invoices submitted as work progresses, do not accord with the nature of an insurer's liability. Once MAS had accepted the Easts' claim and agreed to meet the cost of restoration, it was bound to indemnify them against all costs incurred in accordance with their approved contractual liability. Any failure without proper cause would expose the insurer to serious legal and reputational consequences. As Mr Ring pointed out, such policies work efficiently and effectively in practice and

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7 At [99].
8 At [100].
9 At [26].

his research did not disclose any reported judgment on a dispute of this nature. That is hardly surprising, given the unequivocal nature of the insurer's obligation once it agrees to indemnify.

[26] Third, in argument Mr Campbell confirmed that if MAS was obliged to pay the Easts on an estimate which proved inadequate to meet the restoration costs actually incurred, they would seek the excess from MAS. Conversely, he accepted that if MAS' payment based on an estimate exceeded the actual reinstatement costs, the Easts would be bound to account to MAS for the surplus. However, as he accepted also, the policy does not provide any mechanism either for the Easts to account to MAS for expenditure or to repay a surplus. Arguably, if the declaration was correct, MAS would have no contractual right of recovery of a surplus. The errors made by the Easts' quantity surveyor only serve to reinforce the practical problems inherent in their claim.

[27] Fourth, if MAS was bound to pay the Easts the amount of a reinstatement estimate before incurring any liability, it would be powerless to prevent them from applying the funds for some other purpose. For example, the Easts may never rebuild or restore but obtain by this means payment of an amount equal to replacement value contrary to the policy limitation to indemnity value. The Judge countered this contingency by reference to the contractual provision for forfeiture of all benefits if a claim is found to be fraudulent.[10] However, apart from being placed in a position where it was forced to take legal action, MAS would face difficulties in proving that the claim was in fact fraudulent.

[28] These problems arise because the interpretation adopted by the Judge is contrary to the insurer's underlying obligation to indemnify against a liability to pay the actual amount required to reinstate – nothing more, nor nothing less: the insurer does not agree to pay in advance of liability being incurred by the insured party on an estimate or some other undefined measure of the amount required to rebuild.

[29] We should add that, contrary to the Judge's conclusion, we are not satisfied that MAS' approach – that its liability to cover the cost only arises when those costs

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[10] At [29].

are actually or about to be incurred – "place[s …] a strict and cumbersome fetter on the prima facie right to replacement value compensation".[11] The Easts' right to settlement on that basis is absolute once they incur a contractual obligation for the purpose of restoring the building: it has no bearing upon the timing of and basis for liability. The first two grounds given to support that conclusion do not actually advance it. And the requirement that replacement value is to be objectively assessed by the criteria of reasonableness and floor area only reinforces the importance of requiring a fixed and reliable measure, available through the medium of a contractual obligation, for that loss. Finally, the absence of a mechanism in the policy providing for MAS' incremental assessment and approval of costs is irrelevant given its underlying obligation to indemnify according to any approved liability assumed by the Easts.

[30] Accordingly, for these reasons, we are satisfied that the Judge erred in making the first declaration and it must be set aside.

Second issue

[31] On the second issue of construction of the policy, the Judge found the standard for rebuilding or restoring the Easts' dwelling to a condition substantially the same as new means that it is to be in accordance with the building consent requirements as they exist currently. The essence of his reasoning is as follows:

> [103] Contrary to Mr Horne's opening submission, the standard is not "when as new in 2007". It may be that Mr Horne was relying on the 2006 version of the policy which used the words "when new". But that policy wording changed to "as new" in the now 2008 version. The clear implication of the change is that the policy contemplates a restoration to a condition as new at the time of the rebuild or restoration, not "when new" in 2007. Moreover, "as new" naturally implies rebuild or restoration of the home in accordance with contemporary standards. This is reinforced by the obligation to meet current statutory requirements.
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> [104] I accept that "a condition substantially the same as new" does not mean completely new. It is an approximate standard. Nevertheless the policy plainly envisages and the parties could reasonably expect, that contemporary standards for building works, applying modern materials and meeting minimum building requirements, will be adopted.
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> …

[11] At [24].

> [106] Mr Horne contends that these standards are guides only. But in my view they are strong guides and an objective reference point for the purposes of assessing what is required to achieve the substantially the same as new standard. Owners are statutorily required to ensure that "building work carried out by the owner complies with the building consent or if there is no building consent with the building code".[12] Furthermore I reject the submission that substantially the same as new means the standard actually achieved in 2007. Whatever the outcome in 2007, the policy envisages compliance with current minimum standards.
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> [107] Accordingly I consider that "substantially the same as new" means I must be satisfied on the balance of probabilities that the foundation works proposed by Mr Duke are necessary to restore the building to meet the Building Code standards, including B1/VM4 maximum probable differential standard and AS/NZS1170 Structural Design Actions deflection less than 1 in 300.

[32] The brief factual context for considering this issue is that the earthquake did not cause any actual damage to the foundations of the Easts' house. However, it suffered damage due to subsequent settlement. In particular, the framing has been displaced out of plumb along the height of the house; both the ground and upper floors are out of level; the main house floor slab between the garage and the laundry section is cracked; the gib board lining is cracked; and there is a range of associated miscellaneous damage including water penetration around the window frames and misalignments to internal and external doors.[13] All this damage is due largely to settlement.

[33] The experts engaged by the parties agreed that the damage must be repaired by re-levelling in compliance with the Building Code. However, they disagreed about how the levelling should be done:

(a) The Easts' expert was of the view that an underpinning or similar engineering response was necessary in any repair strategy, requiring repair or replacement of the existing foundations with a specifically engineered solution. Work of this nature is necessary to restore the dwelling to meet the standards of a new house built today.

(b) MAS' expert favoured what is called the low mobility grout (LMG) solution, involving injection of grout bulbs into the loose soil around

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12 Section 14B(b) Building Act 2004.

13 At [2].

the foundations to stabilise the surrounding soil and reduce mobility and slumping.[14]

[34] In the event, as Mr Campbell emphasised, the Judge preferred the Easts' expert's view ahead of MAS' expert.[15] His conclusion is unchallenged on appeal.

[35] Mr Ring succinctly summarised the consequential contractual dispute between the parties in this way. The Easts contend the policy means that they are entitled to restoration to a standard where the condition of the dwelling, even if it is better than it was when new, would comply with the Building Code if built in 2015. MAS says that the reinstatement provision limits its liability to the cost of restoring the dwelling to the same condition as it was when new in 2007, including compliance with the Building Code to the same extent that the dwelling did when it was new (but not better) by LMG re-levelling.

[36] In Mr Ring's submission, the use of the phrase "as new" means the equivalent of "as it was when it was new". By comparison, he submitted, the Judge's finding imports wrongly the words "as if it were new" which does not reflect the ordinary use of the language most obviously in the replacement context. He advanced a detailed semantic argument in support. He also submitted that the qualifying words "so far as modern materials allow" and "including any additional cost necessary to comply with any statutory requirements or Territorial Authority by-laws" are only consistent with his construction of MAS' obligations to restore the house "as it was when it was new".

[37] Mr Ring emphasised the fact that the foundations of the dwelling were not themselves damaged in the earthquake. On this basis, he submitted, the regulatory requirements in 2007 did not mandate work on the foundations to make them Code compliant to today's standards. As the foundations were not damaged and no work to them is required, compliance with the 2015 Code is not required. Accordingly MAS is only obliged to pay what would be necessary to comply with the Code in 2007, instead of what Mr Ring submitted was an obligation to pay for a regulatory

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14 At [33].
15 At [108]–[114].

upgrade that is not legally required – by upgrading elements not being repaired or replaced, even if they were currently not up to building standard. On this basis, Mr Ring submitted, the Judge would be required to determine at a subsequent hearing the engineering response which is required to re-level the dwelling in order to achieve restoration to its condition when it was new in 2007.

[38] We reject this submission. In our judgment Whata J was correct. As Mr Campbell submitted, in ordinary language the phrase "as new" where used to require the rebuilt or restored condition of the house is a quality standard, not a temporal standard. The practical problems inherent in MAS' approach are obvious. There must always be an appreciable risk that the Council will refuse to grant a consent if an application to approve restoration work is based upon a Building Code that is no longer current. In that event it would be impossible for MAS to perform its obligation "to comply with any statutory requirements or Territorial Authority by-laws". Accordingly, the insured party is entitled to new for old rather than old for old.

[39] It is irrelevant that the foundations themselves were not damaged. Mr Ring's attempt to sever off and isolate damage to the house from damage to its foundations when they are part of an integrated whole is artificial. What is relevant, as the Judge found, is that without a specific engineering response such as underpinning, the house itself will not be restored to a condition substantially the same as new in accordance with the current Building Code requirements. There is no rational basis for reading down the Easts' right to limit it to the compliance costs with local authority requirements in 2007, not 2015 when the restoration work is to be carried out.

[40] Accordingly this ground of MAS' appeal is dismissed.

Cross-appeal

[41] The Easts sought leave to cross-appeal against Whata J's reservation of leave to determine issues of quantum if the Council was prepared to grant statutory

consent to the Easts to restore the ground conditions by using the LMG method favoured by MAS.[16]

[42] A decision to reserve leave to either party to apply is strictly speaking not a decision which might give rise to a right of appeal. However, in the context of this proceeding, the declarations were made on the Easts' application before building work was commenced, and the course adopted by the Judge was unquestionably available to him and, in our judgment, was appropriate. He was simply meeting the contingency that, despite his own findings about the appropriate engineering solution, the Council may nevertheless approve the solution favoured by MAS. As the consenting authority, the Council has the ultimate word on this issue. It was appropriate for the Judge to reserve leave to settle quantum if the Easts' claim ultimately fell for measure on a different basis from that proposed. The cross-appeal must therefore fail.

Application for leave to adduce further evidence

[43] Immediately prior to the hearing in this Court the Easts applied for leave to adduce further evidence in the form of two documents extracted by Mr East from MAS' website.[17] Both were said by Mr Campbell to be relevant to MAS' approach to cash settlement and pre-construction payments.

[44] We dismiss the application. Documents published by MAS on its own website do not assist us in construing the relevant contractual provisions at issue on this appeal.

Result

[45] The appeal is allowed in part and the first declaration made in the High Court that the policy does not require the cost of rebuilding or restoring the respondents' dwelling has to be incurred or about to be incurred before MAS is liable to pay the replacement value is set aside.

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16 At [116], [117] and [119(c)].
17 Court of Appeal (Civil) Rules 2005, r 45.

[46] The appeal is otherwise dismissed.

[47] The cross-appeal is dismissed.

[48] The application for leave to adduce further evidence is dismissed.

[49] There will be no order for costs or disbursements given that both parties have enjoyed a measure of success.

Solicitors:
Minter Ellison Rudd Watts, Auckland for Appellant
Rhodes & Co, Christchurch for Respondents