LAW & ORDER

Earthquake litigation in the Wild South – part II

The second part of consideration of the New Zealand High Court decision in Wild South Holdings & Maxims Fashion Ltd v QBE

David McCarthy, associate director
Berwin Leighton Paisner LLP

We previously discussed on this page the New Zealand High Court decision in *Wild South Holdings & Maxims Fashion Ltd v QBE*.

Wild South

Wild South concerned entitlement to automatic rights of reinstatement in commercial property insurance in the context of the multiple earthquakes in and around Christchurch during 2010 and 2011.

Wild South and Maxims were, like many owners of commercial buildings in the city, significantly underinsured against replacement cost. They both argued they were entitled to reinstatements after each earthquake causing damage to their buildings.

The Wild South automatic reinstatement of amount (ROA) clause provided: "In the absence of written notice by the insurers or the insured to the contrary, the amount of insurance cancelled by loss or damage is automatically reinstated from the date of loss. The insured undertakes to pay such pro-rata premium at the rate applicable to the item or items concerned as may be required for the reinstatement."

QBE, meanwhile, argued it was entitled to give notice of cancellation of the ROAs at any time up until it had actually paid the claims for the September 2010 earthquake.

Justice Fogarty determined in *Wild South* QBE only had a reasonable period of time (after the insured suffered a loss) in which to give notice. It remained possible, therefore, based on that decision, insurers could give notice retrospectively to cancel the ROAs, provided a reasonable period of time had not elapsed.

Central Christchurch following the 2011 quake
NigelSpiers/Shutterstock.com

Justice Fogarty determined in *Wild South* QBE only had a reasonable period of time (after the insured suffered a loss) in which to give notice. It remained possible, therefore, based on that decision, insurers could give notice retrospectively to cancel the ROAs, provided a reasonable period of time had not elapsed

Since *Wild South*, two further important judgments on reinstatement of coverage for commercial building owners have been handed down by the New Zealand High Court. These decisions have, for the time being, removed any prospect notice can be given retrospectively by insurers to cancel ROAs.

The first is the judgment of Justice Dobson in *Marriott v Vero Insurance* handed down on November 26, 2013, heard in late October 2013 (*Insurance Day*, Nov 21, 2013). The second is the judgment of Justice Cooper in *Crystal Imports v Lloyd's & Sirius International Insurance Group*, handed down on December 19, 2013.

Marriott

In *Marriott* two small adjoining commercial buildings in Christchurch were damaged in the September 2010 and February 2011 earthquakes. The owners also contended the June 2011 earthquake caused further damage (whereas Vero argued the buildings were "destroyed" for policy purposes by that point). The total sums insured for the buildings were NZ$600,000 ($501,420), but the total repair costs were estimated to be more than NZ$2m.

In October 2013 Vero paid the Marriotts an indemnity value of NZ$460,000 (plus the applicable tax) calculated on depreciated cost of replacement of the buildings and purported to give notice of cancellation of the ROA.

The Marriotts did not dispute Vero's entitlement to elect to pay them indemnity value as an interim payment, but were also seeking the balance of their estimated repair costs. They also contended notice could only be given prospectively under the ROA, before the relevant earthquake.

Dobson J considered the use of the phrase "as from" within the ROA suggested some form of retrospectivity was contemplated. Nevertheless, he was not satisfied this was enough to transform a provision, which would otherwise work prospectively, into a provision available to either party on a retrospective basis. He therefore concluded the ROA was to be interpreted so the event of loss operates as a trigger for a claim, leading to a reduction in the extent of the insurance available to the insured. Reinstatement would then occur from that point and did not need to await quantification of the claim.

The Marriotts' interpretation notice must be given prospectively under the ROA was therefore upheld. While not additionally entitled to repair costs (under the primary indemnity obligation in the policy), Dobson J found the Marriotts were entitled (under the reinstatement memorandum) to an additional payment for the reasonable costs of reinstatement actually incurred up to the policy limits.

Crystal Imports

The preliminary issues in *Crystal Imports* were heard before both *Wild South* and *Marriott*.

In *Crystal Imports* five commercial buildings in and around the commercial retail areas of Christchurch were either damaged or demolished as a result of the September 2010 and February 2011 earthquakes. The sums insured of these buildings totalled NZ$20m. It appears, again, the buildings may have been materially underinsured compared to replacement cost.

A very similar right of reinstatement to the ROAs in the Wild South and Marriott policies existed in this case and assumed potential importance for the same reason.

The insurers argued a statement at the outset of the insurance certificate their liability will not exceed the sums insured meant during the period of the policy the insured's claims were limited to the applicable sums insured.

Cooper J concluded this interpretation would have the effect of "robbing" the ROA of its evidently intended effect.

He therefore concluded reinstatement under the ROA was immediate upon the occurrence of damage (in the absence of notice to the contrary). If it were otherwise, he said the insurers could effectively limit the ambit of the ROA by simply delaying the payment of a valid claim.

Question of unrepaired damage

A further interesting point that arose in *Crystal Imports* was whether any unrepaired damage from the September 2010 earthquake merged with the subsequent destruction of the same buildings in the February 2011 earthquake by operation of the doctrine of merger. In an earlier case, *Ridgecrest v IAG*, Dobson J had held the doctrine of merger did not apply outside the field of marine insurance.

That conclusion has subsequently been questioned by a number of commentators and was challenged by the insurers in *Crystal Imports*. Cooper J reviewed the relevant authorities and concluded the doctrine of merger could apply equally to marine and non-marine insurance. In this context, therefore, the insurers were found liable to indemnify Crystal Imports for the separate damage caused by the September 2010 earthquake, but limited to sums that had already been paid out at the time of the February 2011 earthquake.

The judgments in *Marriott* and *Crystal Imports* have both been appealed against to the New Zealand Court of Appeal, with an expedited hearing date fixed for March 4 and 5, 2014.

Reinsurers and reinsureds with exposure to claims arising from the earthquakes need to carefully consider whether ROAs exist, how such have been managed and if there are any reserving implications arising from them.