LESSONS LEARNED

CHRISTCHURCH EXPERT EARTHQUAKE ENGINEERING PANEL

LEGACY DOCUMENT 7

GUIDANCE FOR ENGINEERS ON

INSURANCE LAW

engineering new zealand
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THE LEGACY PROJECT :: GUIDANCE FOR ENGINEERS ON INSURANCE LAW

Disclaimer – this is a general commentary of the possible issues an Engineer may face in carrying out their duties. It is not specific legal advice and should not be relied upon. You should seek advice from your own legal advisor.

WHAT IS INSURANCE LAW?

Insurance law is a subset of contract law. This means that the first and most important question about any issue is: what does the policy say? Often this will resolve the issue. For instance, where the insurance policy schedule sets a sum insured, the insurer will not usually pay for repair or rebuild costs in excess of this sum.

WHAT IS CONTRACT LAW?

Contract law is about interpreting the words used in a written contract to work out the shared intention of the parties to the contract at the time the contract was formed. While the words themselves are most important, various interpretive tools are also used; the most useful is context. For instance, it can be assumed that a homeowner's policy won't typically cover damage due to deferred maintenance, so an interpretation to that effect would need to be supported by very clear language.

INSURANCE POLICIES

Historically, insurance policies were simple contracts where the perils insured against were all that was covered. For instance, until the 1970s, most building policies would cover damage from fire, flood, and storm. Under such a policy, impact damage from a vehicle crashing into the insured building was not covered. These are known as specified risk policies.

From the 1980s on, most building policies have been drafted with a broad insuring clause; for instance, one which covers "sudden accidental damage" to the insured property no matter what the cause. This broad cover is then refined and narrowed by exclusion clauses, such as an exclusion for intentional damage caused by the insured. These types of policies are known as all risks policies. This type of policy is the most common type of property insurance in New Zealand and is more comprehensive than specified peril policies, but the policy wordings are necessarily longer and more complex. The devil is in the detail.

NATURAL DISASTER INSURANCE

The cost of reinstating natural disaster damage to residential dwellings (excluding flood and storm) is covered by Toka Tū Ake/EQC up to the applicable statutory cap. The Y homeowners' private insurance policy covers natural disaster damage reinstatement costs over EQC's liability and limited to the sum insured using what is known as a 'write back' or 'top up' provision.

Toka Tū Ake/EQC also provides statutory insurance cover for natural disaster damage to residential land, including flood and storm damage.

USEFUL CONCEPTS

It is helpful to consider two connected concepts:

1. Indemnity; and
2. Insurable interest.

Insurance policies are contracts of indemnity. Their primary purpose is to indemnify the insured where they have suffered loss. Indemnity is simply a way of saying that the insurer is liable to pay the proven loss suffered by the insured. Depending on the policy wording, this may be by replacing, rebuilding or repairing the insured property or by paying money to the insured. Strictly speaking, an indemnity should leave the insured no better or worse off than they were before the insured loss or damage occurred. However, modern policies will often pay on a replacement or reinstatement basis, that is a "new for old" basis, because a strict application of the indemnity principle would leave the owner of an older property with a considerable shortfall. Whether an upfront cash payment of the replacement, repair or rebuild cost is possible will depend on the policy wording, although it can also be agreed between the insurer and insured and is common after a natural disaster.

Some policies are indemnity only or 'old for old' policies. In such cases it may be necessary to calculate whether a repair or replacement involves betterment which is not covered by the policy and whether indemnifying the insured requires the insurer to pay the market value of the insured property or the depreciated reinstatement cost.

Insurance policies are agreements that on the happening of a particular event (sudden physical loss or damage) to the insured property, the insurer will indemnify the insured in one of the ways set out in the policy. To trigger a policy response, the insured party must be able to show that the insured event has affected some interest they have in the insured property. This is known as "insured interest" and is best thought of as some sort of ownership or financial interest in the insured property.

THE IMPORTANT QUESTIONS

The home or building owner has the burden of proving, on the balance of probabilities, the actual disaster damage suffered and what is required to remedy the damage.[1] For engineers advising on a homeowner's damage, the most important considerations within policy wordings are:

1. What is the damage?
2. What has caused the damage; and
3. How does the policy respond to the damage?

> **Note:** Question 3 is a legal, rather than engineering question. Engineers should seek guidance from their instructing solicitors or Engineering NZ on the policy response. See further below.

What is damage?

Most building policies will cover physical loss and/or physical damage. Physical loss (where the dwelling may have physically gone (for example, where it has been swept away by a landslide or tsunami) is

[1] See for example, *Body Corporate 335089 v Vero Insurance New Zealand* [2020] NZHC 2353 [Salisbury] at [55] and *Jarden v Lumley General Insurance (NZ) Ltd* [2015] NZHC 1427 at [47] to [54].

reasonably uncommon with a dwelling,[2] so historically the main consideration has been what is the natural disaster damage? In *Technology Holdings v IAG*, Woodhouse J explored the limits of the meaning of 'damage' concluding:[3]

> *Something must happen to the property itself, followed by the impairment of value or usefulness, for damage to occur. That is the factor which excludes from cover cases of pure economic loss; cases where nothing happens to the property itself.*

Damage requires "a physical alteration or change, not necessarily permanent or irreparable which impairs the value or usefulness of the thing said to be damaged."[4] However, the effect on the insured interest must be real or "material' in that it must be more than '*de minimis'*.[5]

It is useful to think of building elements as having functional purposes, aesthetic qualities, or a mixture of the two. For instance, damage to the foundations or structural timbers of a home is unlikely to require considerations of the visual aesthetics of those building components. However, a polished floor slab or exposed rafters are visual elements so damage could include a consideration of aesthetic impairment.

An assessment of damage may also hinge on the particular value that the insured person places on an aspect affected by an insured event. Two examples are:

1. A business in Halswell uses high tech precision tooling machines which require floor levels well beyond the usual tolerances. The workshop was constructed to very exacting standards. In the Darfield earthquake the building suffered floor slab cracking and differential settlement. The insurer proposed crack repairs but no other work, as the floor levels were within normal construction tolerances. The business was able to show that the original construction of the workshop building included floor tolerances beyond the norm, and that its machinery could not be properly operated without such levels. The insurer agreed to repair the floor slab to its pre-quake level through applying a topper screed.

2. A case before the CEIT involved questions of whether structural repairs to a well-kept 1930s villa in a special character area had affected the aesthetic qualities of the building. In that case the new foundation slab protruded beyond the footprint of the house, was visible on two aspects, and was unsightly. It was found that the homeowners had specifically bought the home for its visual elements and prior to the earthquakes had done landscaping and renovations to accentuate the style of the home. Therefore, the repair did not meet the policy requirements. It would have been a different outcome had the owner not been able to show that they had valued the villa's appearance or had failed to maintain the home. For instance, the owner of a home of the same age, but in poor

[2] The Courts have found that being deprived of your property, for example where a red placard prevents you from living in your home, is generally not an insured loss (*Kraal v Earthquake Commission* [2015] NZCA 13); nor is being 'red zoned" *O'Loughlin v Tower Insurance Ltd [2013] NZHC 670*

[3] *Technology Holdings Ltd v IAG New Zealand Ltd & Anor* (2009) 15 ANZ Insurance Cases 61-786 at 77,150.

[4] *Parkin v Vero Insurance New Zealand Ltd* [2015[NZHC 1675 at [36].

[5] *Body Corporate 335089 v Vero Insurance New Zealand* [2020] NZHC 2353 [Salisbury] at [57].

condition due to lack of maintenance, would be hard pressed to show that visual amenity was important to them.

Causation

As an engineer advising on a damage claim, you may be called upon to provide an opinion on the cause of damage to a home. The building owner has to establish the connection between the event and the damage. For damage to be covered by an insurance policy, the event which caused the damage needs to be a risk the policy insures against. For instance, if differential settlement has occurred due to static settlement over time, a policy which insures against "sudden and accidental loss or damage", will not respond. However, there is often a mixture of causes of damage. When advising on these matters, you should use forensic methods to apportion the damage between the different causes. Exactness is not necessary, but cogency is.

In insurance, causation works based on what is known as the proximate cause, also described as the dominant or efficient cause. For instance, if the building covered under a fire policy catches alight, and in putting out the fire the fire service causes water damage, the proximate cause of the water damage is the fire. In this instance, there is an immediate connection between the fire and water damage. However, this can't be taken too far. For example, if a storm damages the roof of a dwelling, the damage to the roof and resulting water damage will be covered by the policy. However, if the homeowner failed to take steps to remedy the roof leak (which could include temporary repairs themselves or advising their insurer who is likely to pay for temporary repairs) and a month later further and worse water damage occurs, the insurer may well take the view that the proximate cause of the second instance damage was the homeowner's lack of care and may exclude the claim.

Tied in with causation is the issue of whether the condition of insured property is such that damage which would otherwise be covered under the policy has a minimal effect on the usefulness of the property. In insurance cases this is known as *de minimus* concept. In short, if the building is in very poor condition and suffers earthquake damage, but that damage does not significantly affect the already poor condition of the building, the policy does not respond. In *He v EQC & OMPL* the building was poorly built and had received no maintenance for decades. It was found that the earthquake damage had not worsened the condition of the foundations which were damaged beyond repair by neglect prior to the earthquakes. In such an instance, it can be seen that the policy does not respond because the insured interest was not detrimentally affected by the earthquake damage (in that it caused no structural, functional or amenity problems).

Policy responses to damage

The most contentious insurance question engineers are likely to be asked to give evidence on is how the remediation strategy they recommend meets the required policy response. As above, this is a legal question, not an engineering question. The policy response and repair standard should be included in the instructions engineers receive from their instructing solicitor. It is also covered off in the Engineering NZ Standard Form Letters of Engagement.

Obviously, the starting point is that the building repair work is to comply with the current Building Code.

Most, if not all, "new for old" policies require the insurer to pay for the repair or rebuild to an 'as new' or a 'when new' repair standard. Strictly speaking, "when new" or "as when new" requires that the standard to

be achieved should be assessed based on the condition of the house when it was first built and 'as new' is based on the condition if that style of house was built today.

The 'as new' repair standard is not very common with most commercial insurers since the Canterbury earthquakes as it can involve a tricky assessment of the required "quality standard not a temporal standard".

The "when new" standard involves:

1. What is required in respect of each element differs in accordance with its purpose.
2. Where an item only has a functional purpose, the policy requires a repair that restores the component to how it functioned when new.
3. Where a component also has, or only has, an aesthetic purpose, the original aesthetic quality of the component must (also) be restored.
4. The restoration is not required to be to the same level as modern standards but rather to the same level as the original standard (subject to the fact that current equivalent building materials and techniques are to be used).
5. The insurer's obligation under the policy is not to provide an identical replica but to render the fact of the earthquake damage immaterial.

However, the impact of repairs on the resale value of the building is not a consideration.

The insurance policy may require the insurer to pay for any regulatory upgrades required when repair or replacement is necessary. This means that Building Act and Building Code questions, particularly about when upgrade of undamaged areas might be required for compliance purposes or if new consent is necessary, can be contentious. It is always necessary to keep in mind that the requirements of the Building Code sit alongside and separately to the standard of repair required by the policy. For instance, in a "as when new" policy wording, it is possible that a code compliant repair will not satisfy the policy. Conversely, in an indemnity policy, a code compliant repair may result in betterment which the policy doesn't cover.

In many instances there will be no material difference between the repairs required to meet the 'as new' or 'when new' repair standard. However, the requirement that any repairs also include regulatory upgrades largely negates the difference between the two standards in most cases. In both instances the target is to return the damaged property to a condition where the damage is no longer a factor.

DISASTER CASE LAW FOR ENGINEERS

The following is a summary of case law deriving from the Canterbury Earthquakes which may be relevant to engineers working in the area of natural disaster damage assessment and repair. There have been changes to residential policy wordings since then, so whether these general principles apply will depend on the specific policy wording in place at the time of the disaster event.

ISSUE	CASE	SUMMARY
Burden of proof *Who needs to prove what?*	*Body Corporate 335089 v Vero Insurance New Zealand* [2020] NZHC 2353 [Salisbury] at [55]. *Jarden v Lumley General Insurance (NZ) Ltd* [2015] NZHC 1427 at [47] to [54].	The home or building owner has the burden of proving, on the balance of probabilities, the actual disaster damage suffered and what is required to remedy the damage.
"Physical Damage"	*Parkin v Vero Insurance New Zealand Ltd* [2015] NZHC 1675 at [36].	"a physical alteration or change, not necessarily permanent or irreparable which impairs the value or usefulness of the thing said to be damaged."
	Bligh v Earthquake Commission [2018] NZHC 2102 at [26]	The damage must affect the use or amenity of the building.
	Body Corporate 335089 v Vero Insurance New Zealand [2020] NZHC 2353 [Salisbury] at [57].	The impairment to the property must be material in the sense that it can be described as more than de minimis.
"Physical Loss"	*O'Loughlin v Tower* [2013] NZHC 1865	The Canterbury Earthquake Recovery Authority "red zoned" the O'Loughlin's land after the Canterbury Earthquake due to the severity of the land damage it suffered. The Crown made voluntary offers to purchase red zoned properties for market value. The High Court confirmed that the creation of the "red zone" did not constitute physical loss or damage to the property such that it would trigger a total loss under the Earthquake Commission Act or the Tower insurance policy. Nor did either provide cover for economic loss.
	Kraal v Earthquake Commission [2014] NZHC 919 and confirmed by the Court of Appeal in *Kraal v Earthquake Commission* [2015] NZCA 13.	Loss of a right to occupy property, (here by virtue of a s.124 notice due to the threat of rock fall) is the loss of the ability to exercise a legal right, not "physical loss" to the property that could trigger a valid claim under the Earthquake Commission Act, this in turn meant the private insurance policy was not triggered either.

ISSUE	CASE	SUMMARY
Land damage	EQC v Insurance Council of New Zealand Incorporated [2014] NZHC 3138 at [70]	Land damage requires a physical change or loss to the body of the land that has occurred, or is imminent, as the direct result of a natural disaster and which affects the use and amenity of that land.
Exacerbation of damage	He v Earthquake Commission [2019] NZCA 373 at [8]	Pre-existing damage is not a barrier to a claim for disaster damage. Where there is pre-existing damage and deterioration in the insured property, the additional physical effects caused by a natural disaster must make a **material difference** to the value or usefulness of the land to be damage the Earthquake Commission Act will respond to.
Multiple Events	*Ridgecrest New Zealand Limited v IAG New Zealand Ltd* [2014] NZSC 129	The question was whether the insured could recover repair costs for damage caused in successive events. Ridgecrest was entitled to be paid for damage up to the limit of the sum insured for each event. The doctrine of merger is inconsistent with an event-based policy, where liability is reset after each event. The indemnity principle caps claims at the replacement value and prevents claims for damage to the same elements of a building. Also, look out for automatic reinstatement of insurance clauses – this may require the engineer to apportion damage to different events.
Aggregation Clauses	*Moore v IAG New Zealand Limited* [2020] NZCA 310 at [32] and [33].	The aggregation clause provided that "one event" was "*a single event or a serious of events which have the same cause."* The Court of Appeal found that "a series of events causing a series of losses (temporarily proximate and linked) will have the same cause only if they have the same proximate cause in the usual sense….. the direct cause … the dominant cause, or the real efficient cause.

ISSUE	CASE	SUMMARY
		So different earthquakes could not be aggregated into "one event" and the Court of Appeal also noted that two storms eight months apart, caused by global warning, that caused damage to insured property would not be aggregated into one event.
Policy Repair Standard "when new" or 'as when new"[6]	*Body Corporate 328564 v Vero Insurance New Zealand Ltd* [2022] NZHC 2716 at [97] - summarising the relevant authorities.	The "when new" standard, involves: a. What is required in respect of each element differs in accordance with its purpose. b. Where an item only has a functional purpose, the policy requires a repair that restores the component to how it functioned when new. Where a component also has, or only has, an aesthetic purpose, the original aesthetic quality of the component must (also) be restored. c. The restoration is not required to be to the same level as modern standards but rather to the same level as the original standard (subject to the fact that current equivalent building materials and techniques are to be used) d. the insurer's obligation under the policy is not to provide an identical replica but to render the fact of the earthquake damage immaterial.
	Parkin v Vero Insurance New Zealand Ltd [2015[NZHC 1675	The impact of repairs on the resale value of the building is not a consideration
Policy Repair Standard "as new"[7]	*East v Medical Assurance Society of New Zealand Ltd* [2014] NZHC 3399 at [103]-[104] and affirmed by the High Court in *Medical Assurance*	'As new' in relation to the rebuilt or restored condition of a building, involves a quality standard not a temporal standard.

[6] Colloquially this could be described as based on the condition of the house when it was first built.

[7] 'As new' policies are not very common post the Canterbury Earthquakes. Colloquially this could be described as based on the condition if that style of house was built today.

ISSUE	CASE	SUMMARY
	Society Ltd v East [2015] NZCA 250 at [38].	
	C & S Kelly Properties Ltd v Earthquake Commission [2017] NZHC 1583 at [126];	There are difficulties in applying a 2017 standard to a house built in the early 1900's. For this reason, special engineering designs, with emphasis on practicality over strict adherence to recently developed guidelines, are required to repair the house to a current "as new" standard.
"Building materials and construction methods commonly used at the time of loss or damage"	*Myall v Tower Insurance Ltd* [2017] NZHC 251 at [43] and affirmed by the Court of Appeal in *Myall v Tower Insurance Ltd* [2017] NZCA 561	Where the original specifications 16 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. Court of Appeal: The insurer need only pay the minimum sum required to meet the policy standard.
Sections 17 and 112 of the Building Act 2004	*Fitzgerald v IAG New Zealand Ltd* [2018] NZHC 3447 at [47] and [50].	Section 17 of the BA requires that all building work must comply with the Building Code to the extent required by the BA. Sections 112 and 42A of the BA specify that, after repair, the building as a whole must continue to comply with the Building Code to the extent that it did before the repair or alteration. The BA does not require the repaired building to comply as it if were a new building. This means that the BA only requires the aspects of the house that are being repaired to be brought up to current compliance levels. Elements that are not repaired may be left at the same level of compliance as they were originally.