IN THE HIGH COURT OF NEW ZEALAND
CHRISTCHURCH REGISTRY

CIV-2012-409-2138
[2013] NZHC 298

BETWEEN	TJK (NZ) LIMITED Plaintiff
AND	MITSUI SUMITOMO INSURANCE COMPANY LIMITED Defendant

Hearing: 28 January 2013

Counsel: N R Campbell, P J Woods and L Taylor for Plaintiff
B Gray QC and A J McElhinney for Defendant

Judgment: 22 February 2013

JUDGMENT OF MILLER J

Introduction

[1] Clarendon Tower, an office building at 78 Worcester Street, Christchurch, suffered damage in the earthquakes of 4 September 2010 and 22 February 2011. The Canterbury Earthquake Recovery Authority (CERA) has pronounced the building dangerous and commissioned its demolition.

[2] The owner, TJK (NZ) Limited, insured the building with Mitsui Sumitomo Insurance Co Limited. The policy included an extension under which Mitsui must pay the cost of reinstating earthquake damage up to a specified sum, if TJK elected reinstatement. TJK has done so, but has yet to incur the cost of reinstatement. Whether it takes the form of notional repair or actual rebuilding, reinstatement cost will exceed the building's lost market value following the earthquakes. The parties accordingly agree that lost market value represents the least measure of the building's indemnity value.

[3] TJK says it has suffered a loss, being the indemnity value, and Mitsui must pay that sum now, before reinstatement. In this summary judgment application it seeks declarations to that effect. Mitsui concedes that it must pay the indemnity value, but says it need not do so until TJK incurs the cost of reinstatement.

Context

[4] Clarendon Tower comprised 18 floors with a total lettable area of 12,983 square metres. It was built in 1988, and is said to have been a premium office building. When the first earthquake struck some floors had recently been refurbished.

[5] Mitsui insured TJK for the building under comprehensive Business Package Policies for the periods 13 October 2009 to 13 October 2010, 13 October 2010 to 31 March 2011, and 1 April 2011 to 25 May 2011. I note that the short term of the second policy had nothing to do with the first earthquake - it was altered to coincide with TJK's balance date - and Mitsui cancelled the third policy, which is not presently relevant, as at the last of these dates. The policies were materially identical, except that the reinstatement sum insured was substantially higher under the second policy than the first.

[6] I will examine the policy language later. By way of overview, Mitsui structured the material damage section of each policy in the following way. It first established an indemnity to pay for damage to the property, such indemnity to be satisfied by payment or, at Mitsui's option, repair or replacement. It next added certain automatic extensions, including the costs of demolishing a building, removing contents and disposing of debris. It then excluded all cover for earthquake damage. It finally displayed a menu of additional extensions among which the insured might choose by having them specified in a schedule to the policy.

[7] Two of the additional extensions offered an indemnity for earthquake damage. Under extension number MD020 TJK might recover indemnity value. This extension was not specified in the schedule, but both counsel suggested that it may affect interpretation of the earthquake full reinstatement cover extension,

number MD022, which was. The reinstatement obligation was capped. Schedules to the first and second policies respectively recorded reinstatement sums of $67,125,000 and $78,150,000, of which $55,175,000 and $65,000,000 were allocated to reinstatement of the building including the landlord's fixtures and fittings, and the balance to inflation and demolition costs.

[8] After the first earthquake TJK notified Mitsui of damage and commissioned repairs, which were under way when the second earthquake struck. As at 22 February 2011 work costing $2.4m had been completed. Mitsui has paid for that work.

[9] The building fared badly in the second earthquake. Damage assessment took some time. In the meantime CERA notified TJK, on 2 June 2011, that the building was dangerous and must be demolished.

[10] TJK's solicitor advised Mitsui's solicitors on 11 August 2011 that demolition seemed inevitable, and stated that TJK was entitled to reinstatement cover. He called on Mitsui to pay the demolition costs and/or indemnity value in the meantime. Mitsui evidently never responded to that request, but it has paid nearly $10m for damage from the February earthquake, apparently without explaining how it categorised the payment. The payment may cover the out of pocket costs that TJK has incurred to date from the February earthquake.

[11] I record in passing that I have set aside Mr Campbell's submission that the parties' correspondence evidences an admission that Mitsui faces a present liability to pay. Even if the admission were unequivocal its implications for the present application, which turns on the construction of the policy, would be debateable.

[12] TJK says that the building was damaged beyond repair and must now be rebuilt at a cost of about $90m. Mitsui responds that the building was economically repairable for about $45m-$50m. The dispute turns substantially upon a single question: whether structural steel beams in the north and south elevations experienced low cycle fatigue in the earthquakes. Other important controversies include a lean from which the building suffered and a bulge in structural frames on

the north and south elevations at mid-floor level. Mitsui says the lean may have pre-dated the earthquakes and anyway fell within accepted tolerances, and it thinks the bulge immaterial. It acknowledges that the cost of rebuilding will exceed the reinstatement sum insured under extension MD022.

[13] A valuation prepared as at 30 March 2010 assessed the market value of Clarendon Tower at $37m. That figure is not agreed; Mitsui estimates its value at approximately $30m-$35m. I am not asked to fix quantum here. For present purposes what matters is that lost market value is less than the cost of repairs and represents the lowest measure of indemnity value under the policy. The parties agree that lost market value is the least amount that Mitsui must pay when its obligation to pay falls due. The question is whether it must pay a larger sum by way of reinstatement cost. If so, the Court must decide which of repair or rebuilding represents the correct measure of reinstatement cost.

[14] Neither party will actually get the opportunity to repair the building. CERA has arranged demolition down to ground level, relying on a notice to demolish issued under s 38(4) of the Canterbury Earthquake Recovery Act 2011. TJK must reimburse CERA for the work, which should be completed by 1 March 2013. It seems that TJK will be permitted to rebuild on the same site.

TJK's claim

[15] The pleadings establish that the building suffered damage in the earthquakes and that Mitsui must indemnify TJK under extension MD022. Mitsui has put TJK to proof of its allegation that it means to reinstate, but Mitsui accepted the allegation for the purposes of this hearing. Mr Gray QC acknowledged that had TJK not elected reinstatement, Mitsui must attract a present liability to pay indemnity value, subject to proof of quantum.

[16] The relief sought under the first cause of action comprises declarations that Mitsui is liable to pay at least indemnity value under extension MD022 of each of the first and second policies, whether or not TJK has incurred the cost of reinstatement. TJK pleads that the indemnity value under the first policy was not

less than $9.66m (the estimated cost of repairs from the September earthquake) and under the second policy not less than $31.4m.[1]

[17] Under the second cause of action TJK seeks judgment for indemnity value, and propping and demolition costs.

[18] Under the third cause of action TJK seeks declarations that Mitsui must pay the cost of reinstatement, being the cost of repairs after the September earthquake under the first policy and the cost of replacing the building under the second policy after the February earthquake. Mitsui responds that the building was repairable after both earthquakes. It pleads too that the CERA demolition precluded repairs, meaning that liability under extension MD022 is confined to indemnity value anyway. The second plea will assume prominence at trial.

The summary judgment application: the parties' positions

[19] For TJK, Mr Campbell argued that Mitsui's policy was structured in typical form, as an obligation to pay indemnity value and a top-up for reinstatement where the insured elected to reinstate and incurred the cost of doing so. In such a policy the insurer must pay indemnity value on proof of loss; the obligation is not conditional on the insured's election to reinstate or the insured actually incurring any reinstatement cost. He argued, relying on Commonwealth authorities, for a general rule to that effect. Where indemnity value may be measured in different ways under a given policy and the parties disagree about which measure applies, the insurer must pay the least of them, or that which it accepts is applicable, pending settlement of the claim.

[20] For Mitsui, Mr Gray responded that the policy was not structured as an indemnity plus top up. Rather, it provided that the cost of reinstatement must be paid where the insured elected reinstatement, and commercial sense suggests that the insurer should pay such cost as the insured incurs it. Nothing in the policy specified that the insurer must pay the indemnity value before the insured incurs the cost of

[1] The basis on which the latter figure was calculated is unclear.

reinstatement. Nor has any New Zealand court adopted such a rule. It would be inappropriate to do so here, for the rule might depend on expert evidence about New Zealand insurance practice.

Analysis

[21] I turn to examine the policy terms. I preface the discussion by noting that the familiar principles governing a plaintiff's summary judgment application are not in dispute.[2]

The policy terms

[22] I begin with the general indemnity in the material damage section:

> The indemnity
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> *We* will indemnify *you* for *damage* to any of the *insured property* occurring during the *period of insurance*. *You* will be indemnified by payment or, at *our* option, by repair or by replacement of the lost or *damaged* property. Subject to the reinstatement of amount of insurance extension *our* liability will not exceed the total sum insured; or where more than one item is included in the *schedule* will not exceed in respect of each item the sum insured applicable to that item.

The italicised terms find definitions in the policy. It also provided that headings, which I have underlined, are purely descriptive and must not be used for interpretation.

[23] The provision which established that additional extensions applied when specified in a schedule stated:

> Additional extensions
>
> Each of the following extensions will have no effect unless there is a statement in the *schedule* that the particular extensions will apply. They are subject to all the provisions of the policy and of this material damage section (unless otherwise stated). If there is any conflict or inconsistency between this material damage section and the extension, only the extension will

[2] Counsel cited *Krukziener v Hanover Finance Ltd* [2008] NZCA 187 at [26], [2010] NZAR 307. See *Cockburn v C S Development No 2 Ltd* [2010] NZCA 373; *Mitchell v Trustees Executors Ltd* [2011] NZCA 519, (2011) 12 NZCPR 659; *Pemberton v Chappell* [1987] 1 NZLR 1 (CA).

apply. If there is any conflict or inconsistency between extensions, only the more particular extension will apply.

[24] Under extension MD022 Mitsui offered the following indemnity:

> [Mitsui] will pay the cost of *reinstatement* in the event of any *insured property* to which this extension applies suffering *earthquake damage* ... during the *period of insurance*.

[25] The property was deemed destroyed if it was so damaged that, by reason only of that damage, it could not be repaired. Reinstatement meant replacement by an equivalent building where the property was lost or destroyed, or by repair when the damage fell short of destruction:

> *"Reinstatement"* means in respect of *insured property damaged*:
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> a) where property is lost or destroyed, its replacement by an *equivalent building* or by *equivalent plant* as the case may require; or
>
> b) where property is *damaged* but not destroyed, the restoration of the *damaged* portion of the property to a condition substantially the same as, but not better or more extensive than, its condition when new.

[26] The extension included several special provisions, the third of which limited the amount payable:

> 3. Limitations on amount payable
>
> a) Where the work of *reinstatement* is carried out in terms of paragraphs (a) or (b) of the *equivalent building* definition, or on any location other than at the same *site*, *our* liability in respect of the costs of *reinstatement* will not exceed the cost that would have been incurred had *reinstatement* been carried out in terms of the *equivalent building* definition on the same *site*.
>
> b) Where the *insured property* is *damaged* but not *destroyed*, *our* liability will not exceed the amount *we* could have been called upon to pay if the property had been *destroyed*.
>
> c) If *you* elect not to reinstate the property *our* liability under this extension in respect of any item of *insured property* will not exceed the indemnity value of that item.

[27] The fourth special provision prescribed circumstances in which Mitsui would not pay full reinstatement cost:

> 4. Circumstances where this extension does not apply

> No payment of more than the indemnity value will be made under this extension:
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> a) If the work of *reinstatement* is not commenced and carried out with reasonable despatch;
>
> b) Until the cost of *reinstatement* has been actually incurred; or
>
> c) If the property is *damaged*, but not *destroyed*, and the repair of the *damage* is not permissible by reason of any *regulations* or by any reason of the condition of the *undamaged* proportion of the property.

[28] The parties agree that under these provisions reinstatement cost is payable only where the insured elects reinstatement. They agree too that the policy envisaged the insured will reinstate the property itself, then claim the cost from the insurer. Where the insured does not elect reinstatement for earthquake damage, the parties also agree, the insurer must pay indemnity value, and that liability is found not in the general indemnity, nor in the indemnity-only cover under extension MD020, but in extension MD022. (Mr Gray did suggest that the insured might have taken cover under both extensions, but he could point to no substance or process that MD020 could add to the indemnity under MD022.)

[29] Counsel disagreed about the source of Mitsui's obligation to pay indemnity value under extension MD022. Mr Campbell contended that the obligation is implicit in the promise to "pay the cost of reinstatement" where insured property suffers earthquake damage, while Mr Gray submitted that it is found in special provision 3c, under which Mitsui's liability where the insured elects not to reinstate "will not exceed the indemnity value". He argued that the obligation to pay indemnity value arises only where the insured elects not to reinstate.

[30] I do not find Mr Gray's argument persuasive. Special provision 3c did not create a positive obligation to pay indemnity value; rather, it capped the insurer's liability in certain circumstances. Notwithstanding counsels' agreement to the contrary, I am inclined to the view that the general provision about additional extensions (paragraph [23] above) incorporated relevant parts of the material damage section, including the general indemnity (paragraph [22] above), where those parts were consistent with extension MD022. Consistent with that view, the material damage section generally used "indemnity" or "indemnify" in a manner consistent

with the assumption in extension MD022 that reinstatement value would never be less than indemnity value. The primary indemnity envisaged that Mitsui would indemnify the insured "by payment or, at [Mitsui's] option, by repair or by replacement" of the affected property. The same approach to indemnity value would seem to apply to earthquake cover unless the relevant earthquake extension provided otherwise. I find support for that construction in extension MD020, which provided only that Mitsui "will cover" the insured for earthquake damage, without specifying what "cover" meant.

[31] As noted, both counsel took a different view. My analysis might also allow Mitsui the option of repairing the building under the general indemnity, rather than paying indemnity value, and the implications of that were not explored in argument. Rather than express a final view on the point, then, I will hold that if my analysis is wrong the positive obligation to pay indemnity value was implicit in the extension as a whole. Either way, I do not accept Mr Gray's submission that the insurer's obligation to pay indemnity value arose only where the insured eschewed reinstatement.

[32] That brings me to the question for decision: whether, the insured having elected reinstatement, the insurer need only pay the costs of reinstatement as defined, meaning repair or replacement, and as incurred.

[33] As Mr Gray conceded, the language of special provision 4 is against Mitsui. It provided that "no payment <u>of more than the indemnity value</u> will be made under this extension ... until the cost of reinstatement has been actually incurred." (emphasis added). I accept Mr Campbell's submission that Mitsui's interpretation leaves the underlined words no work to do. In my opinion, special condition 4 both distinguished between indemnity value and reinstatement cost and contemplated that the insurer might have to pay the former before the insured actually incurred the latter. Further, indemnity value and reinstatement cost need not be measured in the same way, and it is not always apt to speak of the insured "incurring" indemnity value as a cost. In this case reinstatement cost meant the cost of repairing the

existing building or replacing it with an equivalent one.[3] The policy did not define "indemnity value", but in a contract of indemnity the term normally means the actual amount of pecuniary loss that the insured suffered when an insured event happened.[4] Lost market value, which happens to be the least measure of indemnity value here, is not a cost that the insured will incur while repairing or replacing the property.

[34] Of course, TJK has elected reinstatement and the parties agree that it has not yet incurred the cost of repair or replacement. That does not preclude payment of indemnity value in this case, as counsel agreed. Under the policy the insured must arrange reinstatement and claim the cost from Mitsui. Having been paid the indemnity value it would simply credit repair or rebuilding costs against that sum as it incurred them, making further claims for reimbursement once those costs exceeded the indemnity sum.

The authorities

[35] I turn to the cases. *CIC Insurance Ltd v Bankstown Football Club Ltd* concerned premises which were damaged by fire.[5] The insurer had agreed to indemnify the Club, and the basis of settlement was reinstatement cost unless the insured elected to claim indemnity value only. The insured had agreed to reinstate with reasonable despatch if at all, failing which the insurer need pay no more than indemnity value. No payment exceeding indemnity value need be made until the cost of reinstatement was actually incurred. The insured sought reinstatement after a fire on 8 January 1992 but the insurer did not pay and without payment the Club could not afford the repairs. On 3 March 1993 the building was so badly damaged by a second fire that it had to be demolished.

[36] The High Court of Australia explained that under a contract of insurance the insurer offers an indemnity which it discharges by paying money to the insured. A given policy may confer upon the insurer a right to make reinstatement instead of

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3 See too Malcolm A Clarke *The Law of Insurance Contracts* (6th ed, Informa UK Ltd, London, 2009) at 925-926.

4 *AMP Fire and General Insurance Company (NZ) Ltd v The Earthquake and War Damage Commission* (1983) 2 ANZ Insurance Cases 60-529 (CA).

5 *CIC Insurance Limited v Bankstown Football Club Limited* (1997) 187 CLR 384.

payment, or upon the insured a right to claim reinstatement as the measure of indemnity. In this case, the claim for reinstatement failed because the Club had not begun the work soon enough, the insurer's wrongful rejection of its claim notwithstanding. But the Club got a declaration that the insurer must pay the indemnity value at the time of the first fire, notwithstanding that the Club had elected to reinstate rather than claim indemnity value. I observe that the Court located that obligation in the policy's general indemnity.

[37] *Brkich & Brkich Enterprises Ltd v American Home Assurance Co* concerned a hotel destroyed by fire.[6] The policy provided an indemnity for replacement cost, but specified that until the insured effected reinstatement the insurer's liability was to be assessed as if the reinstatement clause was omitted. The insured notified the insurer of its intention to rebuild but also lodged interim proofs of loss, which the insurer met by paying the "actual cash value" or indemnity value of the hotel. The insured next entered a contract to have the hotel rebuilt. But it sold the property before the work was done, and the insurer claimed that this development relieved it of the obligation to pay replacement cost. The British Columbia Court of Appeal discussed the law of replacement cost cover, emphasising that the discussion must be subject to the language of any given policy. Finch JA, for the Court, cited *Castellain v Preston* for the proposition that:[7]

> The very foundation ... of every rule which has been applied to insurance law is ... that the contract of insurance ... is a contract of ... indemnity only, and that this contract means that the assured ... shall be fully indemnified but never shall be more than fully indemnified ...

[38] However, the Court noted, an insured who wishes to rebuild and carry on may find such cover inadequate. Citing a 1990 article by Leo Jordan,[8] the Court recognised that such an insured may require cover for depreciation, a loss which had already been suffered when the insured event happened and so would not form part of actual cash value. On recovering depreciation the insured finds itself in a better position than it was when the insured event happened, which both alters the central concept of indemnity that underlies fire insurance and increases moral hazard. For

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6 *Brkich & Brkich Enterprises Ltd v American Home Assurance Co* (1995) 127 DLR (4th) 115 (BCCA).

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

8 Leo John Jordan "What Price Rebuilding?" (1990) 19 The Brief 17.

these reasons an insurer usually offers replacement cover as an optional supplement to actual cash value, and typically the insurer "is only liable for actual cash value, until after timely reconstruction."[9]

[39] *Brescia Furniture Pty Ltd v QBE Insurance (Australia) Ltd* concerned a commercial property destroyed by fire.[10] The policy included a replacement cover extension and gave the insured the option of claiming indemnity value only. The insured elected reinstatement. Hammerschlag J held without discussion that the policy contemplated payment of indemnity value initially, followed by reinstatement cost once the insured incurred it. Courts took a similar view in *Gannon and Associates Ltd v Advocate General Insurance Co*[11] and *Casa Roma Pizza v Gerling Global General Insurance Co*.[12] A tentative observation to the contrary is found in the judgment of Esson JA in *Carlyle v Elite Insurance Co*, but the issue did not arise directly and the other members of the British Columbia Court of Appeal declined to join in that part of the opinion.[13]

[40] *Vintix Pty Ltd v Lumley General Insurance Ltd* involved a commercial building damaged in the 1989 Newcastle earthquake.[14] The policy obliged the insurer to pay the value of the property or the amount of the damage or, at its option, to reinstate or replace the property. It elected to pay the amount of the damage and soon made a partial payment. In response to the earthquake the local authority imposed more rigorous building standards, which increased the repaired building's value. That led the insurer to invoke an average clause in the policy, a defence which it abandoned shortly before trial. For my purposes the significance of the case lies in a claim which the insurer advanced for interest on the partial payment it had made earlier. Giles J dismissed that claim summarily, holding that the payment had recognised the insured was undoubtedly entitled at that time to at least that amount.

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9 At 129.

10 *Brescia Furniture Pty Ltd v QBE Insurance (Australia) Ltd* (2007) 14 ANZ Insurance Cases 61-740 (NSWSC).

11 *Gannon and Associates Ltd v Advocate General Insurance Co of Canada* (1984) 32 Man R (2d) 1 (MBQB).

12 *Casa Rome Pizza, Spaghetti & Steak House v Gerling Global General Insurance Company* (1994) 87 BCLR (2d) 60 (BCCA), at [18].

13 *Carlyle v Elite Insurance Co* (1986) 25 DLR (4th) 740 (BCCA).

14 *Vintix Pty Ltd v Lumley General Insurance Ltd* (1991) 24 NSWLR 627.

[41] I accept Mr Gray's submission that the question in any case, including this one, is one of interpretation of the policy. It would be going too far to hold that the overseas authorities establish a rule of law that indemnity value is immediately payable where an insured elects reinstatement, but they do aid interpretation. Their persuasive value does not depend, in my opinion, on an inquiry into custom and practice in the New Zealand insurance industry. Mitsui's policy, as I put to counsel during the hearing, is probably not peculiar to New Zealand, and its structure is remarkably similar to the policies examined in the authorities. Some of the policy language is near-identical. That is hardly surprising, for insured risks are much the same everywhere and the authorities suggest a common heritage in English law and practice.

Conclusion

[42] I hold that the earthquake reinstatement extension in Mitsui's policy expressly recognised that indemnity value might be payable in some circumstances, and further that it might be payable before TJK incurred reinstatement costs. Put another way, the extension provided for payment of both indemnity value and the difference between indemnity value and reinstatement cost. The latter sum - the difference - is what extension MD022 meant by "the cost of" reinstatement.

[43] Because reinstatement cover was an additional extension to the primary indemnity, applicable only where the insured chose to repair or rebuild, the insurer's obligation to pay reinstatement cost would arise only as the insured incurred such cost. That rationale cannot affect the obligation to pay indemnity value, which compensates the insured for a loss suffered when the building was damaged. The insured need not put a payment for indemnity value to any particular use; in particular, it need not reinstate the property.

[44] The policy did not provide expressly that where the insured elected reinstatement the insurer must pay indemnity value on proof of loss, but such a term would be redundant. The obligation to pay was affected only where the insured elected reinstatement, and only to the extent that reinstatement would compensate

the insured for a loss – depreciation - for which it would not otherwise be indemnified at all.

[45] Earthquakes damaged Clarendon Tower so as to cause substantial loss for which Mitsui had promised to indemnify TJK. On those agreed facts, and subject to proof of loss, Mitsui must pay TJK not less than the indemnity value of the building.

[46] This last conclusion does not distinguish between the first and second policies, in the interests of caution. The pleadings suggest that the problem of unremedied and perhaps cumulative damage from successive events and its relationship to measures of loss and policy limits may arise here (see paragraphs [16] and [18] above), but it was not explored in argument.[15] So I do not decide whether TJK may recover repair costs that it anticipated following the first earthquake but did not actually incur, in addition to the building's lost market value after both earthquakes.

Discretion

[47] Declaratory relief is discretionary, and this is a summary judgment application in which the plaintiff seeks relief for only part of the claim. However, Mr Gray did not dispute that a declaration may serve a valuable purpose. It should result in Mitsui making a further payment before the trial, which is scheduled for August 2013.

Decision

[48] TJK will have a declaration that subject to proof of loss and credit for sums already paid, Mitsui is presently liable to pay TJK not less than the indemnity value of Clarendon Tower. I decline to make a separate declaration for each policy.

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15 See *Ridgecrest NZ Ltd v IAG New Zealand Ltd* [2012] NZHC 2954.

[49] TJK will also have costs of the summary judgment application, which I am disposed to fix on a 2B basis with provision for two counsel. Counsel may file memoranda if they cannot agree.

Miller J

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