

[1] This decision clarifies how to calculate the maximum amount of cover provided by the Earthquake Commission (EQC) to homeowners with fire insurance.

Background

[2] A D Ltd (A) had fire insurance from Tower Insurance Ltd (Tower) over a block of eight residential flats in Christchurch.

[3] Those flats were damaged during the 22 February 2011 Canterbury earthquake and claims for the repair of that damage were made by A against EQC and Tower.

[4] When EQC determined that the repair cost exceeded its maximum liability, it paid A \$637,552.18. It now concedes that there was an error in its earlier calculations, admitting that the full entitlement should have been \$707,452.52, leaving a shortfall owing of \$69,900.34.

[5] A does not accept either of the calculations made by EQC and claims that its true entitlement (after deduction of the 1% excess) is \$828,000. It says that the shortfall of \$190,447.82 should be paid to it pending settlement of its claim with Tower and seeks interest on that sum under the Interest on Money Claims Act 2016.

[6] Tower takes a neutral stance and has not participated in the exchange of submissions.

Issue

[7] The difference between the two sets of calculations, one by A and the other by EQC, has been caused by the parties using different statutory provisions to make those calculations: A uses section 18(1)(c) of the Earthquake Commission Act 1993 (the Act); EQC relies on s18(1)(b).

Approach

[8] This is an exercise in statutory interpretation in which I am required to ascertain the meaning of s 18 from its text and in the light of its purpose.¹ To do this I will:

¹ Interpretation Act 1999, s 5(1).

- (a) examine the circumstances in which the Act was passed;
- (b) set out the full text of s 18 of the Act;
- (c) examine the structure of s 18; and
- (d) use that structure to calculate A's entitlement.

Legislative context

[9] The Act, which came into force on 1 January 1994, replaced the Earthquake and War Damage Act 1944 and was intended "to make provision with respect to the insurance of residential property against damage caused by certain natural disasters."²

[10] Broadly speaking, the Act was intended to reconstitute the Earthquake and War Damage Commission as the Earthquake Commission, phase-out cover by the Commission for non-residential property, and remove coverage for war damage. Most significantly, however, it replaced indemnity cover with replacement cover; whereas the old Act had offered full indemnity cover to the amount specified in the fire insurance policy, the new Act offered replacement cover up to specified limits. The rationale behind this change is explained in the following passage from the speech made by the associate Minister of Finance (the Honourable Maurice McTighe) when he introduced the Bill to the house in December 1992:

I should like to take this opportunity to elaborate on the reforms as they affect homeowners. Currently the maximum amount that the Commission pays out to a homeowner is the indemnity or market value of the property that is damaged in an earthquake or other disaster. In most cases the replacement cost of the home are much higher than its indemnity value. About 75% of New Zealand homes have an indemnity value of \$85,000 or less, which means that under current arrangements 75% of claims against the Commission would be limited to \$85,000. That requires homeowners to take out additional insurance to cover the total replacement value of the homes to meet the shortfall themselves. That is the old regime.

Under the new proposal the Commission will pay homeowners a total replacement value of up to \$100,000 plus Goods and Services Tax... A total of \$112,500. It means that for most homes the cover that is offered by the Commission will in a majority of instances be fully sufficient to rebuild homes that are destroyed by earthquakes or other natural disasters. The value of improvements is generally about two thirds of the total value of residential property.

² Earthquake Commission Act 1993.

I would also make it clear that in most disasters the underlying land will be unaffected. Thus the \$112,500 figure should serve to protect the value of most home improvements. For many people the changes will do away with the need for top-up insurance cover. For many people the changes will reduce the level of private insurance that is required for total replacement.

Section 18 of the Earthquake Commission Act 1993

[11] Section 18 of the Earthquake Commission Act 1993 provides:³

18 Residential buildings

- (1) Subject to any regulations made under this Act and to Schedule 3, where a person enters into a contract of fire insurance with an insurance company in respect of any residential building situated in New Zealand, the residential building shall, while that contract is in force, be deemed to be insured under this Act against natural disaster damage for its replacement value to the amount (exclusive of goods and services tax) which is the least of-
 - (a) if the contract of fire insurance specifies a replacement sum insured for which the building is insured against fire under that contract, the amount of that sum insured:
 - (b) if the contract of fire insurance does not specify such a replacement sum insured but does specify an amount to which the building is to be insured under this Act, that amount:
 - (c) the amount arrived at by multiplying the number of dwellings in the building (being the number determined in accordance with subsection (3)) by \$100,000 or such higher amount as may be fixed from time to time for the purposes of this paragraph by regulations made under this Act.
- (2) An amount specified for the purposes of subsection (1)(b) shall not be less than the amount calculated by multiplying \$1,000, or such higher sum as is fixed from time to time for the purposes of this subsection by regulations made under this Act, by the area in square metres of the residential building. Where a contract specifies a lesser amount, the amount specified is deemed to be the amount calculated by multiplying \$1,000 or such higher sum as is fixed from time to time for the purposes of this subsection by regulations made under this Act, by the area in square metres of the residential building.
- (3) For the purposes of subsection (1)(c), a residential building is deemed to comprise 1 dwelling unless the existence of a higher number of dwellings in the building is disclosed to the insurance company at the time that the contract of fire insurance is entered into.

Analysis of the section

[12] Section 18 of the Act provides every owner of a residential building that is insured for fire with an assurance that their building will be insured with EQC in the event of a natural disaster.

³ Now repealed, applicable to the date of the event.

[13] Section 18(1) sets out the basic parameters of that cover. Limits are placed on EQC's liability in respect of each individual claim to limit its exposure in the event of a major disaster. In no case will EQC be liable on any one claim for more than \$100,000.⁴ Where there are different methods of calculating liability under the Act, cover is limited to the lowest of the various options.

[14] Those different methods of calculating EQC's liability under the Act are detailed in s 18(1)'s three sub-paragraphs as follows:

- (a) the amount specified in the policy for replacement fire insurance cover;
- (b) the amount specified in the insurance policy for natural disaster cover if (a) does not apply; and
- (c) \$100,000 for every dwelling covered by the policy.

[15] Because EQC's liability under the Act is the lesser of those three alternatives, and because that liability can never exceed \$100,000, s 18(1)(a) and (b) only apply if the specified sums mentioned in them are less than \$100,000.

[16] It should be noted that s 18(1)(a) only applies if the specified figure is for replacement cover; if it is for indemnity cover, then s 18(1)(c) applies instead.

[17] More unusually, because s 18(1)(b) applies only when s 18(1)(a) does not, if the fire insurance policy specifies separate sums for both fire insurance and natural disaster damage, the amount of natural disaster cover will be the amount specified for fire insurance. This could lead to some strange results:

- (a) if the policy fixes fire replacement cover at \$90,000 and natural disaster cover at \$95,000, then cover for natural disaster damage under the Act will be for \$90,000;

⁴ All sums mentioned in this decision are exclusive of GST.

- (b) if the policy fixes fire replacement cover at \$95,000 and natural disaster cover at \$90,000, then cover for natural disaster damage under the Act will be for \$95,000;
- (c) if the policy fixes fire replacement cover at \$120,000 and natural disaster cover at \$95,000, then cover for natural disaster damage under the Act will be for \$100,000.⁵

[18] Although s 18(1)(b) enables homeowners to nominate their own level of cover under the Act, s 18(2) prevents them nominating a sum less than the amount calculated by multiplying the area of the building in square metres by \$1,000. Moreover, this option is not effective if that calculation exceeds \$100,000. This option, therefore, is only open to those insuring a residential building smaller than 100 m²

[19] This relationship between the area of the building and the maximum cover is probably no coincidence. If the \$1,000 per square metre mentioned in s 18(2) was a 1992 estimate of the cost of re-building (and my recollection is that this is possible), then full cover was being offered when the Act was passed to those whose homes were 100 m² or less, leaving those with larger or more expensively designed homes requiring top-up natural disaster cover from their private insurers. That appears to be consistent with the comments made by the Associate Minister of Finance referred to above on the introduction of the Bill in 1992.

[20] It is interesting to note in this context that the explanatory note to the Earthquake Commission Amendment Bill 2019, when referring to increasing the build-cost rate from \$1,000 to \$2,500 per m², states:⁶

The build-cost rate is designed to reduce under-insurance by requiring that the value of a property for the purposes of insurance under the Act is not less than the specified minimum value per square metre.

[21] After taking all that into account, I consider that the purpose of s 18, when enacted, was to:

- (a) limit EQC's exposure in the event of a major natural disaster; and

⁵ Because (b) doesn't apply and (c) is lower than (a).

⁶ Earthquake Commission Amendment Bill 2018 {37-1} (explanatory note) at 4.

- (b) provide enough cover from the State to:
 - (i) repair natural disaster damage suffered by modest homes; or
 - (ii) contribute significantly towards the costs incurred by those with better homes.

[22] With that in mind, I consider that the purpose of s 18(2) is to prevent homeowners from nominating an unrealistically low figure for natural disaster cover which might inhibit their ability to repair or replace their home.

[23] Inflation may have impeded the effectiveness of this policy, but the recent amendments have certainly gone some way towards rectifying that.

Calculating A's entitlement

[24] A's cover under the Act is best explored by examining each of the sub-paragraphs in s 18(1) to see whether they apply, and, if they do, making appropriate calculations to determine which alternative produces the lowest amount.

[25] Section 18(1)(a) only applies if each of A's fire insurance policies specifies a replacement sum. All eight policies of fire insurance with Tower are for "full replacement value" and do not specify a replacement sum. A and EQC agree that this option does not apply.

[26] Section 18(1)(b) only applies if A's fire insurance policies do not specify a replacement sum but does specify an amount for which the building is to be insured under the Act. A says that this option does not apply; EQC says that it does but does not explain why.

[27] Certainly, both agree that the fire insurance policies do not specify a replacement sum (hence their agreement that the first option does not apply) so, for this option to apply, EQC must believe that the policies specify "an amount to which the building is to be insured under [the] Act." I am unable to understand how they have arrived at this conclusion, as the only

reference in the policies to cover is "full replacement value" without any figure being stipulated that might limit the amount to which the building is insured under the Act.

[28] EQC's method of calculation involves multiplying each square metre of the flat by \$1000, presumably in reliance on s 18(2). Although there has been an interesting debate between EQC and A about whether the area of the flat includes the area of the garage, nothing turns on it. Subsection (2) involves a comparison between a sum specified in the policy and the product derived from multiplying the area of the flat by \$1,000, but I am unable to see the relevance of this calculation when there is no specified figure with which to compare it.

[29] I find that there is nothing in any of the A policies with Tower that would cause A's cover under the Act to be limited by s 18(1)(b).

[30] The only sub-paragraph that applies, therefore, is s 18(1)(c), under which the amount of cover is calculated by multiplying the number of dwellings in the building by \$100,000. As each of the eight policies held by A with Tower relates to only one flat, the amount payable under each policy is \$100,000 plus GST, making a total due by EQC to A of \$828,000, of which \$190,447.82 is outstanding.

Interest

[31] Before I determine whether interest is payable under the Interest on Money Claims Act, I require submissions from both EQC and A which should address whether an award of interest should be made, and if so, the date from which it should run.

[32] I direct, therefore, that:

- (a) A's submissions are to be filed by 31 January 2020;
- (b) EQC's submissions in reply are to be filed by 14 February 2020; and

(c) A's response is to be filed by 21 February 2020.

A handwritten signature in blue ink, appearing to read 'C P Somerville', with a stylized flourish at the end.

C P Somerville
Chair
Canterbury Earthquakes Insurance Tribunal