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## Overview

[1] This case demonstrates how to resolve disputes between homeowners and insurers who have agreed on the repairs needed to meet the policy standard but cannot agree on how to manage those repairs.

### *Background*

[2] M and M's house at xxx, Christchurch, suffered earthquake damage in the Canterbury earthquake sequence, primarily the earthquakes in September 2010 and February 2011.

[3] EQC attempted to repair that damage in 2013 but the repairs to the plaster cladding on the exterior of the house were inadequate and further repairs were undertaken in 2015. Those repairs were no more successful and, in 2018, EQC paid out its full liability to M and M without making any deduction for the cost of the repairs they had undertaken.

[4] M and M then made a claim under their State Insurance home policy against IAG, which quickly accepted liability to repair the earthquake damage to the house.

[5] M and M had already engaged their own architectural consultants and appointed Whyte Construction Ltd (WCL) as their builder. After some negotiation with IAG it was agreed that the following repairs were required to bring the house up to the policy standard:

- (a) the replacement of the plaster cladding and all windows on the exterior of the house, (including one window iron constructed partially in the wall and partially on the roof);
- (b) the replacement of the pitched roof, not because it was damaged in the earthquake, but because the building was originally constructed with minimal eaves which needed extending to cover the increased depth of the cladding;
- (c) the replacement of the Butyl membrane on the flat roof, not only because it needed to extend over the extra depth of the cladding, but also because it had suffered earthquake damage; and
- (d) other, less significant, repairs.

[6] The Ms' architect scoped the work required to undertake the repairs and prepared a full set of plans and specifications. An application for a building consent is ready to be lodged and WCL, which has already submitted an estimated price for undertaking the repairs, is able to start work in early 2020.

*The issues*

[7] The Ms' State Insurance policy requires them to obtain IAG's permission before they incur any expense in connection with their claim. When they submitted their plans, specifications, and estimate to IAG for approval, it expressed concern about the price and questioned six items in the scope of works.

[8] The parties agreed to submit their dispute about the scope of the repair work to the Tribunal for a preliminary ruling. They also asked it to design a process under which the parties, or the Tribunal if agreement cannot be reached, can determine what is a reasonable cost for the repairs.

[9] Mr Johnson also asked for an indication as to how the parties should deal with water damaged framing should any be encountered when the wall cladding is removed.

[10] In resolving these issues for the parties, I will:

- (a) examine the policy document;
- (b) seek guidance from the general law of insurance and from case law developed following the Christchurch earthquakes;
- (c) use these sources to formulate a method for resolving the issues before the Tribunal; and
- (d) use that method to evaluate the issues.

*The policy*

[11] Under the heading "repair, rebuild or pay cash?" on page 7 of the Ms' State Insurance policy it says:

If you have a loss that is covered by this policy and you repair or rebuild the home, we'll pay:

1. the cost of repairing or rebuilding the home to a condition as similar as possible to when it was new, using current materials and methods; and
2. any cost of compliance with government or local authority bylaws or regulations, as long as:
  - (a) we pay the cost of compliance only for that part of the home that has suffered loss covered by this policy, and
  - (b) the home complied with all requirements that existed at the time it was originally built and at the time of any alteration.

We won't pay these costs if you've been given notice of non-compliance before the loss happened.

3. The following costs, as long as they were necessarily and reasonably incurred:
  - (a) architects', engineers', surveyors', building consultants', legal and Council fees,
  - (b) cost of demolition and of removing debris and contents,
  - (c) cost of up to \$2500 to restore or reconstruct any part of the garden or lawn within the boundary of the home that was damaged or destroyed while the home was being repaired or rebuilt.

If you don't repair or rebuild the home, we'll pay you the fair value of the loss based on the present value of the home.

"Present value" means the market value of the home, excluding the value of the land.

[12] There is no issue in this case about whether the proposed works comply with the policy standard. IAG's only concern is about cost; although it is willing to pay the reasonable cost of the repairs required to repair the earthquake damage, it considers that some of the work specified in the scope of works is not necessary. It also requires reassurance about the reasonableness of the price submitted by WCL.

[13] In this context, the following passage on page 6 of the policy under the heading "Getting our permission first" is relevant:

You must ask for our permission before you:

- incur any expenses in connection with a claim under this policy, or
- negotiate, pay, settle, or admit any allegation that you are legally liable, or

- do anything that may prejudice our rights of recovery.

...

It is best that you allow us to manage your claim on your behalf. We'll let you know how you can help us when we talk to you about your claim.

[14] It is noticeable from these two sections of the policy that:

- (a) although the costs of professional fees, Council fees, and demolition are qualified as being "necessarily and reasonably incurred" there is no such qualification about the cost of repairing or rebuilding the home;
- (b) IAG prefers to manage the claim itself; and
- (c) There is no qualification placed on IAG's right to refuse permission for the policyholder to incur any repair expenses

### *The Law*

[15] Property insurance, such as the State Insurance home policy the M's had with IAG, is but one class of insurance and is subject to rules that apply more generally.

[16] One of those general rules is that a contract of insurance imposes a duty of utmost good faith. Initially, this duty was imposed to manage the moral hazard of fraudulent claims being made by an insured,<sup>1</sup> but more recently that duty has been seen as a mutual obligation.<sup>2</sup>

[17] There are also general rules that govern how an insurance company should evaluate the evidence submitted by an insured when making a claim.<sup>3</sup> Although at first sight it might appear obvious that the issue of whether the policyholder has suffered a loss covered by the policy is a question of fact which should be determined objectively, that has never been the legal position. Initially, the courts considered that it was sufficient for the insurer to act with bona fides when assessing the evidence, a subjective test,<sup>4</sup> but now the courts consider that where an entitlement to a benefit under an insurance policy turns on the opinion of the insurer, the insurer

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<sup>1</sup> *Carter v Boehm* (1766) 3 Burr 1905.

<sup>2</sup> Merkin and Nicoll *Colinvaux's Law of Insurance in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2017).at [4.8.1].

<sup>3</sup> At [7.2(5)].

<sup>4</sup> *Manby v Gresham Life Assurance Co* (1861) 4 LT 347.

must act reasonably in considering the matter and in forming its opinion.<sup>5</sup> It is not for the court to substitute its view about what is a reasonable attitude to take to the evidence submitted, as "reasonable persons may reasonably take different views".<sup>6</sup> Instead, the court may only interfere if the insured is able to establish that the decision of the insurer was not reasonably open to it.<sup>7</sup> In that regard, the test resembles the unreasonableness test applied by the court when reviewing administrative decisions.

[18] The insurance company's decision-making, however, does not occur in a vacuum. In analysing the reasonableness of its decision, the court must consider, among other things, whether:

- (a) the insurer correctly interpreted the policy by considering and determining the correct questions;
- (b) any expert whose opinion has been sought was provided with all the relevant information and asked the right questions;
- (c) the insurer addressed the correct questions either directly, or indirectly with the aid of the expert's opinion, and took account of the relevant information;
- (d) the insurer observed its duty of good faith and fair dealing, particularly by having due regard to the interests of the insured, as a mortgagee would do when exercising a power of sale of mortgaged property.<sup>8</sup>

[19] Unfortunately, I have not been able to find any discussion of this issue in the decisions that have resulted from the Christchurch earthquakes. Davidson J came closest in *Emmons Developments New Zealand Ltd v Mitsui Sumitomo Insurance Co Ltd & Vero Insurance New Zealand Ltd* when he said at [54] that "there must not be an unreasonable approach to reinstatement which reflects in greater *and unnecessary* costs to the insurer"<sup>9</sup> but that is simply

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<sup>5</sup> *Equiticorp Industries Group Ltd (in stat man) v Hawkins (No 11)* (1993) 8 ANZ Insurance Cases 61-207 (HC) at 75,267.

<sup>6</sup> *Edwards v The Hunter Valley Co-op Dairy Co Ltd* (1992) 7 ANZ Insurance Cases 61-113, 77,536 (NSWSC). Cited with approval in *Cigna Life Insurance New Zealand Ltd v Rowles* HC Wellington AP131/96, 2 May 1997 at 10; and *Keith v AMP Life Ltd* HC Christchurch CP40/98, 21 May 1998 at 5.

<sup>7</sup> *Van der Noll v Sovereign Assurance Co Ltd* [2013] NZHC 3051 at [97].

<sup>8</sup> At [94].

<sup>9</sup> *Emmons Developments New Zealand Ltd v Mitsui Sumitomo Insurance Co Ltd* [2019] NZHC 277.

a statement that an insurer has no duty to accept an unreasonable approach to repair. It says nothing about how the court should evaluate an insurer's rejection of a reasonable approach.

### *Discussion*

[20] The rights and obligations of the M's and IAG are governed by the law of contract and are to be found in the terms of the insurance contract between them. On the issues before me, I interpret the policy provisions set out by me at paragraphs [11] and [13] above, as follows:

- (a) Although the provisions on page 6 of the policy record that permission must be sought before incurring any "expenses" and the provisions on page 7 oblige IAG to pay "costs", there is no meaningful difference between these words: the Concise Oxford Dictionary defines "expense" as "the cost incurred in or required for something". These words are clearly synonyms.
- (b) The third part of the provisions under the heading "repair, rebuild or pay cash" on page 7 of the policy is intended to make clear that these ancillary costs of professional fees, Council's fees, demolition and removal costs and the cost of landscape restoration are included in the cover under the policy although they are not strictly repair or rebuilding costs.
- (c) The incorporation in that third part of the phrase "as long as they were necessarily and reasonably incurred" only applies to that part and is not to be imported into either part 1 or part 2. Nor does that phrase remove the obligation on the insured to seek IAG's consent; it simply lists the two criteria to be applied by IAG when deciding whether to grant permission for these expenses to be incurred.
- (d) The insured must seek the consent of IAG before incurring any repair or rebuilding costs.

[21] The authorities to which I have referred in [17] all relate to decisions about either the granting of cover under an insurance policy or the extension of that cover for a further period. I consider, however, that the insurer's power to refuse permission for the incurring of repair or rebuild costs ought to be treated in a similar fashion; it would be unconscionable to allow an



insurer with an obligation to act with the utmost good faith to wield unbridled power over the repair or rebuild process.

[22] Because the cost of the repair over which IAG wishes to exert control is inevitably related to the nature and extent of the repair, its control of the cost automatically provides it with control over the process of repair. Similarly, control over the process of repair provides control over the cost. I consider that it is appropriate to require IAG in those circumstances to act reasonably. The best method of ensuring that is by implying a condition to that effect into the insurance contract.

[23] This view is reinforced by the comment made by Woodhouse J in *van deer Noll v Sovereign Assurance Co Ltd*<sup>10</sup> that the insurer's obligation to have due regard to the interests of the insured, although derived from the duty of good faith and fair dealing, is contractual in nature rather than fiduciary.<sup>11</sup>

[24] It would be appropriate, therefore, to amend the “permission” provision in the insurance contract by grafting on an implied condition as follows:

You must ask for our permission before you:

- incur any expenses in connection with a claim under this policy, or
- negotiate, pay, settle, or admit any allegation that you are legally liable, or
- do anything that may prejudice our rights of recovery

*provided however that we will always have due regard to your interests and will not unreasonably withhold our permission.*

[25] It is inevitable in disputes about the method of repair, that the reasonableness of the insurer's position will largely be determined by how it has struck the balance between its interests and those of the insured. Homeowners are constantly balancing cost and risk when they undertake their own renovations or building projects. Insurers refer to this issue when they ask homeowners how they would manage the risk if they were using their own money, but insurers could equally be asked how much they would pay if they were bearing the risk themselves. The truth lies in the middle: a balance must be struck between the cost to the

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<sup>10</sup> *Van der Noll v Sovereign Assurance Co Ltd*, above n 7.

<sup>11</sup> At [94(f)].

insurer and the risk to the insured. When the insurer takes control of the decision-making, it must not act unreasonably in striking that balance.

### *Formulation of approach*

[26] Although the parties may not have appreciated it, their scope dispute is about IAG's refusal to give permission for the Ms' to incur six expenses. The M's, who want me to review that decision, have the onus of establishing that IAG has acted unreasonably in withholding that permission. Only if I consider that IAG has been unreasonable am I able to impose my own view about what is reasonable.

[27] When it comes to the question of the total repair cost, IAG has yet to decide whether to give permission to incur the repair costs itemised in the WCL estimate. Instead, it has outlined a process it intends to follow before it makes that decision. The M's must satisfy me that this is an unreasonable process before I can impose what I consider to be a reasonable process.

[28] I will examine each decision taken (and the process to be followed in making the decision not yet made) individually by:

- (a) setting out the proposed options;
- (b) identifying the risks and discussing how they should be managed;
- (c) analysing how the proposed options manage those risks; and
- (d) considering whether IAG's decision to withhold permission for the Ms' to incur the cost of their option was reasonably open to them.

### **Scope of works dispute**

[29] M and M challenge IAG's refusal to give permission to incur the following repair expenses:

- (a) removing and replacing the Velux skylights as part of the replacement of the pitched roofs;

- (b) removing and replacing the existing plywood substrate when installing a new butyl membrane on the "flat" roof;
- (c) including the roof in the encapsulation of the dwelling and garage;
- (d) glue-blocking the timber flooring on the upper level of the house with its associated cost of partial demolition of the plasterboard ceilings in the lower level;
- (e) obtaining a master builder guarantee; and
- (f) incurring professional fees for site observation and certification.

### *Skylights*

[30] The existing pitched metal roof needs to be removed, not because it suffered damage during the earthquakes, but because:

- (a) the eaves need to be extended to cover the replaced wall cladding which is now wider than before; and
- (b) the membrane to be laid on the flat roofed section of the house between the garage and the house proper, needs to extend 300 mm under the iron where the roofs meet.

[31] The roof of the house has five skylights. The Ms' propose that these skylights be replaced while the iron is being replaced, giving them a "whole of roof" guarantee; IAG is withholding permission, saying that the skylights do not need replacing as they have suffered no earthquake damage and are currently watertight.

The risks and how to manage them

[32] Because all five skylights are Velux products which have internal seals and flashings installed in the factory, it is possible that the windows might have suffered invisible internal earthquake damage.

[33] M is also concerned about the likelihood that the skylights suffered some wracking during the earthquakes and need to be re-set.

[34] Because the life of a skylight is far greater than the length of the guarantee, there is a risk that the weather tightness of the skylights might fail outside the guarantee period.

[35] Finally, there is a risk of divided responsibility for a weather tightness failure. There is no escaping the division of responsibility between the supplier and the installer, but the problem becomes significantly worse if some elements in the roofing system have been replaced and others have not, especially when items that have not been replaced are showing signs of age.

[36] Complete replacement of the skylights removes the risks posed by internal damage, wracking, and age, while at the same time providing the M's with a "whole of roof" guarantee, thereby reducing the risk of divided responsibility in the event of failure.

#### Analysis

[37] I find that there is only a low risk of the windows leaking in future due to invisible damage or wracking:

- (a) Despite their age, the Velux skylights have never leaked, not even after the earthquakes nine years ago that caused damage to other parts of the house. Had they been damaged or wracked during the initial earthquakes or in the 20,000 or so subsequent after-shocks, it is reasonable to expect that they would have leaked, especially as the house is in a wind zone designated as "extra high". As there is no sign that these skylights have leaked, it is unlikely, therefore, that these windows have suffered earthquake damage.
- (b) Although the skylights are certainly old, the fact that they have not leaked is consistent with their good reputation and demonstrates that they were well installed initially and properly maintained thereafter. Moreover, the installation of the new roof will involve each skylight being re-flashed with specially designed new flashings.

[38] The risk that the windows might deteriorate with age and develop leaks is a risk that the Ms' had before the earthquakes, and I do not consider that IAG has a responsibility to manage this risk for the Ms' who, if they wish, can decide to replace the windows at their own expense.

## Conclusion

[39] I therefore consider that IAG has not acted unreasonably in withholding permission for the Ms' to add the cost of replacing the skylights to the cost of the repairs being undertaken at IAG's expense.

### *Replacing the substrate on the flat roof*

[40] There is a flat roof in the middle of the house between the pitched iron roofs over the garage on one side and the house proper on the other. This roof is clad in a butyl membrane over a plywood substrate and is unchanged from when the house was built 30 years ago.

[41] The existing substrate was supposedly built with a fall of 1:60 (1°) but on inspection was found to have falls between 1:68 to 1:73 and with one area measured at 1:291. That is consistent with the report from Accredited Building Surveyors Ltd, who inspected the property in November 2018, that "water was ponding on the roof approximately 12 hours after the last rainfall". SJ Gordon Design Ltd also reported ponding on the roof when they inspected the property for IAG in February 2019.

[42] Repairs to this roof are necessary as there are signs that it was damaged during the earthquakes. For example, some fixings have penetrated from below, there are signs that the fabric has stretched in places, and some of the membrane has pulled away from the substrate. Although the plywood substrate below the membrane now has high moisture levels, there is no evidence that this moisture has penetrated the interior linings of the house.

[43] The surface of the membrane has developed a patina associated with age, and some of the failed fixings are probably due to corrosion of the nails caused by preservatives in the plywood.

[44] This flat roof also needs to be extended at the eaves to cover the increase in depth of the cladding.

## Options

[45] M and M propose removing the existing butyl membrane and substrate and replacing them with Ardex Butanol laid over a new plywood substrate.

[46] IAG, however, considers that there is a cheaper option. It proposes leaving the existing butyl membrane in place, re-fixing the existing plywood substrate with countersunk screws through the existing membrane, and then laying a Viking Enviroclad FBS (fleece backed system) membrane glued to the existing membrane. No details were provided as to how the existing substrate would be extended to cover the deeper cladding.

[47] Although the Artex Butanol proposed by the Ms' and the Viking Enviroclad suggested by IAG are similar products, the latter is more modern (2015 as opposed to 2005) and more versatile. For example, the Enviroclad proposed by IAG is fleece-backed enabling it to be installed over rough substrate such as concrete and tongue and groove timber. According to the Viking publicity material, *"the fleece-back bonds with the substrate and beds in, providing an aesthetic, smooth membrane surface finish. An unsightly rough substrate would otherwise show through any non-fleece backed single ply membrane."*

[48] Moreover, IAG relies on the claim made in the same publicity material that the Viking fleece-backed membrane can be overlaid on an existing substrate, resulting in cost savings (no reconstruction or dumping of roof) and avoiding exposing the interior of the building to the risk of leaking during installation.

[49] The essential difference between the parties is that the M's intend to use the Ardex Butanol as an Acceptable Solution for which a building consent is automatically available, whereas IAG wishes to use the Viking Enviroclad FBS membrane as an Alternative Solution for which a producer statement from a designer is required.

[50] It is not easy to determine the cost differential between these two proposals. Although the Butanol is cheaper than the Enviroclad FBS, use of the former as an acceptable solution requires the removal and replacement of the existing substrate whereas IAG claims that its

alternative solution does not. Although WCL estimates that it will cost \$2794.50 to remove the butanol, substrate and purlins, it is not possible to identify the estimated cost of replacing them.

#### Obtaining a building consent

[51] The building consent required for this work can be obtained in several different ways, of which three are the most relevant:

- (a) by complying with an Acceptable Solution approved under section 23 of the Building Act 2004;<sup>12</sup>
- (b) by complying with every relevant condition in a current Product Certificate issued under section 269 of the Building Act 2004;<sup>13</sup> or
- (c) by satisfying the Christchurch City Council on reasonable grounds that the plans and specifications for the proposed work will comply with the provisions of the building code (known as an Alternative Solution).<sup>14</sup>

[52] IAG accepts that the method proposed by the M's for repairing the flat roof would automatically qualify for a building consent under either of the first two options, but claims that the method it proposes, using the Viking Enviroclad FBS, is likely to be granted a building consent as an Acceptable Solution.

#### The risks and how to manage them

[53] Flat or near flat roofs have come under scrutiny over the last two decades in the aftermath of the leaky buildings' crisis. There appear to be three principal areas of risk: ponding, delamination, and age.

- (a) Water ponding on the membrane can become heated and cause deterioration of the membrane. It can also cause delamination of the laps.

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<sup>12</sup> Building Act 2004, s 19(1)(b).

<sup>13</sup> Building Act, s 19(1)(d).

<sup>14</sup> Building Act, s 49(1).

- (b) Delamination, when the membrane pulls away from the substrate, causes it to deteriorate quickly.
- (c) Not only does the membrane deteriorate with age, but it has been discovered that nails used to secure the substrate can become corroded over time, either by the entry of water or by the action of the preservatives in the plywood. In either case, the nails expand, pop up, and penetrate the membrane.

[54] MBIE in its Acceptable Solution E2/AS1 manages these risks by:

- (a) increasing the gradient of the substrate from 1:60 to 1:30 (1° to 2 to degree);
- (b) increasing the thickness of the plywood substrate from 15 mm to 17 mm;
- (c) requiring the fixings to be countersunk screws rather than nails;
- (d) banning the use of plywood treated with light organic solvent preservatives; and
- (e) requiring installation only by those trained and approved by the manufacturer of the product.

[55] Meanwhile, manufacturers have improved the quality of their respective products and Viking has increased the width of its product to 3.66 m to reduce the number of laps. This compares with the width of the Butanol at 1.4 m.

[56] Both membranes have been granted Product Certificates under section 23 of the Building Act 2004 by BRANZ and Codemark if they are installed in conformity with acceptable solution E2/AS1.<sup>15</sup>

[57] Each product has also been approved for use with an Alternative Solution, but the Butanol approval is very restricted whereas the Enviroclad membrane can be used on specifically designed buildings that are:

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<sup>15</sup> 3rd edition July 2005 (Amendment six, 14 February 2014).



- (a) subject to specific structural and weather tightness design;
- (b) with substrates of plywood or concrete slab;
- (c) situated in specific design wind pressures; and
- (d) with the weather tightness design of junctions for each specific structure being the responsibility of the building designer.

[58] It is relevant to note in this context that the 20-year guarantee given by Viking for the Enviroclad FPS membrane specifically excludes any loss of waterproofing properties or damage caused by “the lack of positive drainage (ponded water)”. This is consistent with the technical statement produced by Viking for this product which, after saying that the product can be overlaid over an existing substrate, says that:

- (a) it is suitable for low slope and pitched roofs;
- (b) it has been assessed as a roof waterproofing membrane on buildings within the scope and limitations of acceptable solution E2/AS1 (which require 2° falls as a minimum);
- (c) product specification and incorporation of the material into the building design must be carried out by a designer/architect/engineer or a building professional who has ready access to the technical specifications including installation details and standards referenced in both BRANZ appraisal 656 (which specifies a minimum fall of 2°) and Codemark certificate GM-CM 30058-RevB (which also specifies a minimum 2° fall);
- (d) installation must be carried out by a Viking trained and licensed installer who must complete the substrate checklist which, for plywood, obliges the installer to confirm that the minimum roof fall of 2° has been met; and
- (e) the full list of installation requirements is contained in the Codemark certificate (which requires a 2° fall).

How the parties propose to manage those risks

[59] Proposing an Acceptable Solution is simply a fast-track way of obtaining a building consent. As already mentioned in [55], complying with an Acceptable Solution is not the only means of obtaining a building consent<sup>16</sup> and IAG is entitled to suggest that the building consent be obtained using an Alternative Solution. Whichever approach is taken, the result is a building consent signifying that the proposed construction method will comply with the appropriate performance standards of the Building Code.

[60] The performance standards for roofs require that they:

- (a) be constructed to provide adequate resistance to penetration by and the accumulation of moisture from the outside;<sup>17</sup>
- (b) shed precipitated moisture/melted snow;<sup>18</sup> and
- (c) prevent the penetration of water that could cause undue dampness, damage to building elements, or both.<sup>19</sup>

[61] A useful publication issued in May 2017 by BRANZ,<sup>20</sup> suggests that an applicant for approval of an alternative roofing solution should:

- (a) identify aspects that fall outside the Acceptable Solution;
- (b) identify the clause in the Building Code for which performance must be demonstrated by design and supported by information;
- (c) identify the performance criteria that apply;
- (d) select the most relevant compliance paths;

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<sup>16</sup> Building Act, s 23.

<sup>17</sup> Building Regulations 1992, sch 1 at E2.

<sup>18</sup> At E2.3.

<sup>19</sup> At E2.3.2.

<sup>20</sup> Branz.co.nz (ed) *Branz facts Roof Design #4 – What can go wrong with roofs* (online looseleaf ed, Branz.co.nz).

- (e) determine what sort of information is required to demonstrate compliance; and
- (f) provide the evidence supporting compliance, such as information from the manufacturer, BRANZ and Codemark.

[62] Although it is not for the Tribunal to determine whether a building consent will be issued, if IAG wishes to submit that an Acceptable Solution is reasonably open to it in this case, the Tribunal expects that:

- (a) the Alternative Solution is supported by plans and specifications prepared by a suitably qualified designer who is prepared to contract with the homeowners to supply a PS1 certificate to the appropriate consenting authority in support of a consent for that Alternative Solution;
- (b) the designer has provided IAG with the information outlined in [61] above;
- (c) IAG has closely questioned that designer about that information and received satisfactory responses;
- (d) IAG has evaluated the above material and decided that there is a reasonable prospect of a building consent being granted for the Alternative Solution;
- (e) IAG has obtained an assurance from:
  - (i) the manufacturer of the membrane that it will provide a warranty for its product if laid in accordance with the Alternative Solution; and
  - (ii) a suitably qualified roofer that is prepared to contract with the homeowners to undertake the work for a specified sum and provide a warranty for that work.

[63] IAG provided no evidence that it has engaged in that process, and questions remain about:

- (a) How it proposes to deal with:

- (i) the areas on which water currently ponds;
  - (ii) the eaves extension;
  - (iii) the risk that nails in the substrate will pop up in future;
  - (iv) the shrinkage issue; and
  - (v) whether the Enviroclad FBS will bond with the old butyl membrane;
- (b) the significance or otherwise of:
- (i) the falls on the substrate being half those recommended in the Acceptable Solution; and
  - (ii) the plywood in the substrate being thinner than is recommended in the Acceptable Solution.

[64] It is not enough for IAG to simply rely upon the evidence of Mr Creighton, who is qualified neither as a designer nor as a roofer, that he installed a Viking Enviroclad FBS membrane over an existing plywood substrate on a property at sea level in Sumner, Christchurch. Although the roof plan for that house noted that “all existing flat roofs are between 1° and 1.5°” there were no measurements provided to the Tribunal, and in any event, the falls in the present case are less than 1°. There was nothing to indicate whether the plywood was 15 mm or 17 mm. There was no evidence of existing ponding or nails popping up. Finally, none of the material submitted to the Council in support of the application for that building consent was presented in evidence.

[65] The risk being taken by the M’s is a serious weathertight risk that affects the integrity of their house. Having regard to the impact of weathertight failures on the lives of thousands of homeowners in New Zealand, it is not enough for them to have someone to sue in the event of roof failure. Certainly, they would want warranties from the manufacturer of the roofing membrane, the builder, and the roofer but, most importantly, they would want the roof to remain watertight well beyond the life of those warranties. Laying Ardex Butanol over a new plywood substrate conforming with Acceptable Solution E2/AS1 is likely to do just that.

[66] Without the evidence I have already referred to, I cannot say that IAG's tentative Alternative Solution is reasonably open to it.

### Conclusion

[67] I have concluded, therefore, that IAG is acting unreasonably in withholding its consent from the M's incurring the cost of replacing the existing flat roof with Ardex Butanol laid over a new plywood substrate.

### *Scaffold and encapsulation*

[68] WCL's estimate includes total encapsulation of the house, both walls and roof, supported by tubular scaffolding.

[69] IAG accepts the need for tubular scaffolding around the perimeter of the house and garage with shrink wrapping of the exterior of the building to protect the house while the cladding is being replaced, but it does not consider that it is necessary to encapsulate the roof.

[70] IAG 's building expert, Mr Creighton, may well have been right to describe encapsulation as a "luxury", but IAG has already agreed to encapsulation of the house; all that is at issue is the cost of including the roof in that encapsulation.

[71] It is not easy to determine the cost differential between these two options, but I will accept Mr Whyte's estimate of between \$3,000 and \$4,000.

### The risks and how to manage them

[72] There is a risk that moisture will penetrate the building if it rains while any part of the roof is uncovered. This risk, which is inherently high, is aggravated by the house being in the "extra high" wind zone. Not only does this mean a greater likelihood of moisture penetration, but it also means that it will occasionally be too windy to work on the roof.

[73] Encapsulation of the roof will eliminate the risk of moisture penetration entirely and enable the roofers to work continuously whatever the weather. It also reduces the uplift on the encapsulation which would otherwise be difficult to manage.

[74] IAG acknowledges that there is a risk to the M's if it were to rain while the roof was being replaced, but called Mr Creighton to say that this risk could be safely managed by:

- (a) scheduling the roof work to be undertaken during a spell of dry weather;
- (b) managing the work in sections to ensure that the area at risk was kept to a minimum; and
- (c) lining up the inspections with the engineer and building inspector in advance.

[75] Although Mr Creighton indicated that, in a perfect world, the flat roof could be replaced within a couple of days, it became apparent that he was not including the time taken to replace the substrate, extend the eaves, replace the fascia, or install the spouting.

[76] Mr Coulthard, the architectural designer engaged by the M's, did not believe that the work could be undertaken as quickly as Mr Creighton had projected. In his view, the work could not be done in sections and he noted that no allowance had been made for replacing purlins if water damage were discovered under the roof. He also commented that a reasonable allowance should be made for inspections by the engineers and the Council inspectors, over whose timeframes the builder had no control.

[77] I accept Mr Coulthard's estimate that the roof is likely to be uncovered for several weeks.

[78] Mr Whyte, who has been a builder for 40 years, noted that IAG has twice in the past insisted on an exclusion clause in his contract works insurance unless he fully encapsulates the building on which he is working. This was not contradicted by IAG.

#### Analysis and conclusion

[79] Both parties acknowledge that there is a risk of moisture penetration while the roof is removed and agree that it must be managed. I find that the Ms' proposed encapsulation of the roof properly manages that risk, but the real issue is whether IAG was acting unreasonably when it decided that the extra protection afforded by the roof encapsulation did not justify the extra cost.

[80] Mr Creighton was the only witness called by IAG and it is reasonable to presume, therefore, that his was the only opinion it relied upon in reaching its decision on this issue. Flaws in his reasoning will inevitably affect the quality of IAG's decision-making. For example, IAG is likely to have relied upon Mr Creighton's flawed assessment that the roof work could be undertaken in sections and that the house would be at risk for only two days. When it was balancing the cost with the risk, therefore, it had probably underestimated the risk.

[81] Nor can I overlook that IAG is insisting that WCL manages this risk without total encapsulation when it would not be willing to take that risk itself under its contracts work insurance.

### Conclusion

[82] I conclude by finding IAG has acted unreasonably in withholding its permission for the M's to incur the cost of fully encapsulating the house during the course of the repairs.

### *Timber flooring*

[83] Both parties agree that earthquake damage has been suffered by the timber flooring on the upper level of the house, causing unacceptable squeaking. They also agree that the damage to the wooden flooring under the carpeted areas should be addressed by screwing or nailing the floorboards to the joists.

[84] Their disagreement is about how to repair the damage caused to the areas of exposed wooden flooring. IAG proposes that they, also, be re-screwed/re-nailed; the M's believe that this would be unsightly and propose, instead, that the plasterboard ceilings immediately below these areas of exposed floorboards be removed and the floor repaired by timber fillets being glued laterally along two sides of the joists and the underside of the floorboards. This latter proposal involves an additional expense of about \$2000 including margin and GST.

### Conclusion

[85] Both methods of repairing the damage are conventional but the re-screwing/re-nailing proposed by IAG would be noticeable and detract from the appearance of the floor. Bearing in

mind the modest cost differential, IAG's refusal to give permission for the Ms' proposed method of repair is unreasonable.

### *Master Build guarantee*

[86] The original estimate from WCL included \$3060 (including GST) as the cost of a 10-year Master Build guarantee, but at the hearing Mr Johnson advised the Tribunal that WCL had incorrectly calculated the cost of the guarantee; the true cost is \$1550 (including GST).

[87] WCL is a registered master builder and is bound to offer each client the Master Build guarantee. The client must meet the cost of that guarantee but is entitled to decline it. Apparently, others in the building industry offer similar guarantees, but the Master Build guarantee is generally regarded as the best.

[88] A report in October 2018 estimated that a build guarantee or insurance product of a similar sort is supplied on 39% of residential building projects each year.<sup>21</sup> The figure for new-build projects is 53%.

[89] Although Mr Thain for IAG noted that the adjustment to the cost of the Master Build guarantee had reduced its significance in relation to the total cost of the project, he submitted that the cost of this guarantee:

- (a) was about the contractor's performance and not the condition of the building;
- (b) is not covered by the policy because it is not a cost of repairing the home "to a condition as similar as possible to when it was new"; the house will be returned to the policy standard by the repairs, regardless of whether there is a guarantee in place; and
- (c) because the offer of a Master Build guarantee was not available when the house was built, the Ms did not have such a guarantee when the house was new and, therefore, one is not available under the policy.

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<sup>21</sup> Denne T and Beer A (ed) *Guarantees and Insurance Products: market and policy analysis. Guarantees and Insurance Products: market and policy analysis* (online article, MBIE) at [1.10.18].



[90] This analysis of the issue wrongly classifies it as a dispute about the policy standard. The Ms' are not proposing repairs that are outside the cover provided by the policy; they are claiming that the cost of providing a Master Build guarantee is a reasonable cost associated with repairs approved by IAG. As far as I can see, IAG is solely concerned with the cost of the guarantee and has not balanced that cost with the benefits to the Ms' of managing the risk covered by the guarantee.

### Conclusion

[91] In deciding that IAG was acting unreasonably when withholding permission for the Ms' to incur the cost of the Master Build guarantee, I have taken into account:

- (a) the small cost involved;
- (b) the comfort provided by a ten-year guarantee from an independent and, presumably, financially sound entity against the risk of WCL being unable to meet its obligations under the contract;
- (c) that the M's are alert to this risk because one of the builders who carried out the failed EQC repairs could not be held to account after it went into liquidation; and
- (d) that 39% of homeowners paying with their own money for similar work chose to pay for a similar guarantee.

### *Professional fees*

[92] IAG had been concerned that the WCL estimate had doubled up engineering fees, but during the evidence it became clear that the \$12,500 fee charged by the engineers was for the work undertaken so far, including the provision of the PS1 certificate, and that the \$3,500 estimated for observation was simply an estimate for the benefit of the M's of the work that might be involved in replying to requests for information from the council during the consenting process and for any observations that might become necessary. The figure mentioned was like a PC sum: only work actually undertaken would be charged.

## Conclusion

[93] I am satisfied that this is a proper charge and that IAG would be acting unreasonably if it were to withhold permission for this cost to be incurred by the M's. Because this figure is an estimate only, there will be an opportunity later for IAG to consider whether the actual cost is reasonable.

### **Possible framing damage caused by failed EQC repairs**

[94] Both parties are aware that some framing damage directly linked to the failed EQC repairs may be exposed when the exterior cladding on the walls is removed. It is probable that this damage, if any has been incurred, will be related to the ingress of water through the failed repairs.

[95] The estimate from WCL does not include any allowance for the cost of repairing this damage but Mr Johnson, on behalf of M and M, has been hopeful that IAG would meet the cost.

[96] However, it has become apparent that IAG will not meet this cost, which it says is covered by an exclusion to the cover provided by the policy and, in any event, should be the responsibility of EQC with whom the M's have had a confidential settlement.

[97] Mr Johnson wishes to have this area of dispute addressed by the Tribunal to avoid further argument and delay.

[98] I do not consider that this issue has been properly argued and I am, therefore, calling for further submissions.

- (a) Mr Johnson's submissions are to be filed by 31 January 2020;
- (b) Mr Thane's response is to be filed by 14 February 2020; and
- (c) Mr Johnson is to reply to Mr Thane's submissions by 21 February 2020.

## **Overall cost**

[99] The matters already traversed by the Tribunal concern the scope of the repairs: this section of the judgment concerns the cost of those repairs.

[100] IAG has been told by Mr Creighton that the estimate supplied by WCL is unreasonably high. Counsel agree that a method should be established to determine whether that is the case. Mr Johnson proposes that the Tribunal hears evidence, either from the parties' quantity surveyors or from an expert appointed by it to assist; Mr Thain suggests, instead, that the repair work be put out for competitive tender.

### *Using quantity surveyors*

[101] Under this option, the parties would instruct quantity surveyors to provide opinions and then confer in an attempt to reach agreement. If no agreement could be reached, the parties would return to the Tribunal for a ruling. Before the hearing, the Tribunal would appoint its own quantity surveyor as an expert to assist at the hearing. That person would attend the hearing only to ask questions and not to give evidence.

[102] Alternatively, the Tribunal could appoint its own quantity surveyor at the outset and seek an opinion on the reasonableness of the price submitted by WCL. When that report was available, the parties would consider it and possibly consult their own experts. The lawyers would then confer to try and reach agreement. If they could not agree, they would seek a ruling and call their own quantity surveyors to give evidence. The Tribunal's quantity surveyor would also give evidence.

[103] As a third alternative, the parties might agree to submit this dispute to arbitration and be bound by the outcome.

### *Tender*

[104] Under this option, a building consent would be obtained, and the consented work would be sent out for competitive tender. A range of quotations would then be received from which the reasonableness of WCL's price could be determined.

## *Analysis*

[105] Neither process is perfect.

[106] The various alternatives put forward by Mr Johnson assume that WCL will undertake the work, and involves experts providing opinions about the reasonableness of WCL's price for that work.

[107] If the parties' respective experts are polarised and unable to reach agreement, the issue will not be easy to test at a hearing because the opinions of the witnesses are likely to be based on different data.

[108] There is also the problem of what the Ms' should do if this process demonstrates that WCL's price is higher than is reasonable: should they force WCL to reduce its price, seek another builder, or meet the additional costs themselves?

[109] Although the tender process will test the actual market, the outcome of that process will depend not only upon who is asked to tender but also upon their availability, experience, and financial commitments. Will they be the equivalent of WCL in those areas?

[110] Although the parties could each agree to invite an equal number of builders to tender, each side could stack the deck with players whose pricing is likely to support their position.

[111] There is also the problem of how to evaluate the tenders. Presumably they will cover a range of prices, but how should what is reasonable be determined? Is it the range between the highest and lowest tenders? Is it possible for a tender to be unreasonably low or high? What allowance should be made for availability, experience and level of financial commitment?

[112] At the end of the day, each party is likely to be asking a quantity surveyor to evaluate the tenders, and we are back where we started: with the appointment of experts and the possibility of needing a hearing, but with much more delay built into the process.

[113] Although putting repairs out to competitive tender is a good way of finding someone to undertake the work, the M's have already found that person. Instead, the parties are wanting to test the reasonableness of that person's price, and that requires expert evidence.

[114] Calling for a tender does not answer the question; it simply adds more data to the pool used by an expert to form an opinion. Having regard to the huge numbers of building contracts let in Christchurch in recent years, there is more than enough data available upon which a quantity surveyor can form a reliable opinion. A further tender is not necessary.

*Conclusion*

[115] IAG is acting reasonably when it says that it questions the reasonableness of WCL's price, but unreasonably when it demands a tender.

*Process*

[116] I consider that the best process would be for the Tribunal to appoint its own quantity surveyor and seek an opinion as to the reasonableness of WCL's price. Either that opinion will assist the parties in reaching agreement, or it will provide the Tribunal with independent evidence if the matter goes to hearing.

[117] The registrar is directed to convene a telephone conference at which appropriate directions can be made.

C P Somerville  
Chair  
Canterbury Earthquakes Insurance Tribunal