IN THE HIGH COURT OF NEW ZEALAND
CHRISTCHURCH REGISTRY

CIV-2012-409-002385
[2013] NZHC 670

	BETWEEN	MATTHEW JOHN O'LOUGHLIN AND VALERIE JEAN O'LOUGHLIN Plaintiffs
	AND	TOWER INSURANCE LIMITED Defendant

Hearing: 4 - 14 March 2013

Counsel: GDR Shand and KP Sullivan for Plaintiffs
AR Galbraith QC and MC Harris for Defendant

Judgment: 5 April 2013

JUDGMENT OF ASHER J

This judgment was delivered by me on Friday, 5 April 2013 at 2pm pursuant to r 11.5 of the High Court Rules.

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Table of Contents

Introduction

[1] Christchurch suffered two earthquakes on 4 September 2010 and 22 February 2011 and a particularly significant aftershock on 13 June 2011. All three of these events damaged the property of the plaintiffs, Matthew and Valerie O'Loughlin. They have sold the land on which their house was built to the Crown, and will move elsewhere.

[2] The O'Loughlins have brought these proceedings against their insurer, Tower Insurance Ltd (Tower) under their house policy. The policy was taken out on 25 September 2009 and was in force at the time of the three events (the earthquakes). It insures their house but not their land. Tower accepts that there is a valid contract of insurance, there has been an accident in terms of the policy, and the O'Loughlins have suffered loss. Both parties accept that payments made by the Earthquake Commission (EQC) for damage to the house of $203,886.50 must be deducted. Tower has made an offer based on the costs of repair of the O'Loughlins' house, and have now made a payment of net $197,179.15 to them on that basis. Consequently, the O'Loughlins have received a total of $401,065.65 for house damage.

[3] The issue in the proceedings is whether the payment of $197,179.15 has met Tower's obligations under the policy, or whether Tower must pay a larger amount as claimed by the O'Loughlins based on the cost of rebuilding a new house. The O'Loughlins say they should have been paid a net $416,113.50 rather than $197,179.15, which would mean they would have received a total of $620,000 for house damage.

Summary of findings

[4] For convenience, I summarise at the outset the reasoning and the conclusions I have reached below:

(a) The creation of the red zone did not give rise to a claim under the primary insurance clause in the policy. That is a clause covering physical loss or damage to the house. The red zone did not require

physical alteration or repair to the house, and did not prohibit habitation, repair or rebuilding, or the grant of a building consent.[1]

(b) The creation of the red zone did not give rise to a claim under the natural disaster special benefit clause in the policy. The clause extended cover to direct loss arising from measures by proper authorities after earthquakes to reduce their consequences, and did not include the word "physical". However, the wording of the document and the wider commercial context indicate that claims are limited to physical loss or damage to the house, and not economic loss. In any event, no economic loss to the house was proved to arise from the creation of the red zone, given that the creation was accompanied by a CERA offer to buy the house at the 2007 valuation, which has not been shown to be less than the market value at the time of the earthquakes.[2]

(c) Tower has elected to proceed on a repair basis rather than a rebuild or replacement basis, and to settle by making a payment rather than having actual work done. Tower, in offering to pay and making a payment based on the costs of repairing the O'Loughlins' house using a low mobility grout (LMG) injection method to relevel the concrete base, was not acting in accordance with its obligations under the policy. On the evidence presented the LMG method may well encounter serious problems and not secure a building consent. The amount Tower has chosen to pay has not been shown to be the replacement value, and does not equate to the actual cost of bringing the house back "to the same condition and extent as when new" under the insurance contract.[3]

(d) The cost of rebuilding the house on the existing site is $620,000 and on a sound site in a comparable position elsewhere is $540,000.[4]

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1 At [40]–[54].
2 At [55]–[86].
3 At [87]–[158].
4 At [21].

(e) It is explicit in the policy that it is Tower's option whether it makes a payment, rebuilds, replaces or repairs. Tower has elected to make a payment to the O'Loughlins rather than to repair, rebuild or replace. It has not elected to rebuild, and is not bound to pay based on a rebuild. It can pay on another basis such as replacement, provided that the calculation is reasonable and in accordance with its contractual obligations.[5]

(f) If there is a payment based on the costs of rebuilding the O'Loughlins' home, that payment must be on the basis of the costs of rebuilding on a good site ($540,000), not on the present weakened and vulnerable section ($620,000). This is because the O'Loughlins have chosen not to rebuild on the existing damaged site, and both parties have proceeded on the basis of a cash payment which will enable them to purchase elsewhere in Christchurch out of the red zone. They are not entitled to a payment in excess of the cost of replacing the house.[6]

(g) The terms of the policy require Tower to pay for a house for the O'Loughlins that is comparable to the O'Loughlins' house as when new. It does not obligate Tower to pay for a replacement property that is identical in terms of the position, dimensions, building design and finish to the previous house.[7]

(h) The O'Loughlins have succeeded in proving that the offer and payment based on the LMG repair did not meet Tower's contractual obligations. They have not succeeded on their red zone argument, or their claim that Tower must pay on a potential rebuild basis on their existing site. Therefore, the relief sought by them in the present pleading cannot be granted.[8]

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5 At [159]–[172].
6 At [173]–[182].
7 At [173]–[182].
8 At [196]–[200].

(i) Different relief may be granted in accordance with these determinations, but the parties have not made submissions on declarations or orders in accord with these findings. The parties should now make submissions on the exact form of relief that is appropriate. For the same reason, general damages cannot be determined without further submissions.[9]

(j) This judgment is, therefore, an interim judgment.

Events leading to the claim

[5] In 1999–2000, the O'Loughlins owned a property at Gayhurst Road, Dallington. They built an architecturally designed home for themselves on part of the section. The site is approximately 320 square metres, and the floor area of the house is 219 square metres. The foundation is a concrete base slab. The building is timber framed, although there are some supporting steel beams. The external walls are part concrete block, part brick veneer, with plaster over polystyrene in the upper areas. Upstairs there are three double bedrooms, a study and two bathrooms. Downstairs there is a living area, dining room and kitchen, together with a bathroom. There is also a large double garage. It is a comfortable two-storey home, purpose built on a relatively small site.

[6] The value of a replacement property with a similar house and section in a suburb on sound land in Christchurch has been assessed by Tower's valuer Mark Shalders at $500,000 to $525,000 based on existing information. However, he accepted that if the O'Loughlins went out to buy a replacement property on the day he was giving evidence, they would have to pay more, given a rising market.

[7] The property suffered from liquefaction in the earthquakes. It has dropped between 300 and 620 millimetres. The most significant damage is a warping of the concrete base slab, which occurred as the soil beneath liquefied, moved and sank. The level now varies through the slab up to 106 millimetres. Some cracking in the ground floor slab can be observed in two locations, one crack being one to two

[9] At [201]–[203].

millimetres wide and the other less than one millimetre. However, a full inspection of the base slab has not been possible due to the floor coverings, chattels and goods that are in the house and garage. There is some cracking to the wall linings through the house, generally close to the windows or doors. A number of cracks can be observed in the external plaster coating. These are not considered structural. There is no observable damage to the framing.

[8] The O'Loughlins made an initial claim after the first earthquake. They sought to have the house repaired. Tower was cautious, as Christchurch was still suffering from aftershocks. It would not pay for repairs until the aftershocks settled. After the second earthquake, the impact and damage were described by the O'Loughlins as being more severe. The O'Loughlins, after receiving a considerable amount of assistance from family and others, were able to continue living there. They were out of the country when the June aftershock struck. They made further claims under the Tower policies for these events. They also lodged claims with the EQC under the Earthquake Commission Act 1993 (ECA) after each earthquake.

[9] They have settled their claim with Tower in relation to a rental dwelling they owned on the other part of the section. They have not, however, settled the claim for the damage to their home and this is the subject of the proceedings.

[10] In October and November 2011, the EQC made two payments under s 18 of the ECA to the O'Loughlins of $111,211.56 and $90,622.82 for damage resulting to the house from the September and February earthquakes respectively. They related to building damage as distinct from land damage, and were not related to the creation of the red zone.

[11] It is accepted by both sides that a small amount has to be added to those two payments being extra payments received from the EQC by the O'Loughlins, and that the total deduction that Tower is entitled to take into account in calculating its payment obligation to the O'Loughlins is $203,366.50.

[12] On 28 March 2011, the Canterbury Earthquake Recovery Authority (CERA) was established by Order in Council.[10] The Canterbury Earthquake Recovery Act 2011 (CER Act) was enacted on 12 April 2011, with one of its purposes being to provide for CERA's role in the recovery from the earthquakes.[11]

[13] In June 2011, Cabinet decided as part of the Government's response to the earthquakes to create zones in the Christchurch area.[12] The Cabinet papers had identified four zones, based on the severity and extent of land damage, as well as the cost effectiveness and social impacts of land remediation.[13] Those four zones were the green, orange, red and white zones. The red zone was for the worst affected areas. The zones were announced on 23 June 2011. As part of the decision, it was decided that CERA would offer to buy properties in the red zone.

[14] CERA carried out Cabinet's red zone initiative. Under s 53 of the CER Act, the Chief Executive of CERA had the power to acquire property in the name of the Crown. CERA made two alternative offers to homeowners in the red zone: the first to buy the property entirely for a set price, the second to purchase just the land. The O'Loughlins received an offer from CERA on 19 August 2011.

[15] Option one was to buy the O'Loughlins' property for $420,000. The Crown would take over the O'Loughlins' insurance and EQC claims for damage to their house. It was stated that if the house had only minor damage, then option one might be the most suitable option. Option two was for the Crown to buy the land for $110,000 and for the insured to pursue compensation for damage to their home from their insurer. It was stated that option two might be the better option if the insured's house insurance would result in them being paid more for the building and improvements than the rating valuation. This offer will be referred to as the CERA offer.

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10 State Sector (Canterbury Earthquake Recovery Authority) Order 2011, made pursuant to s 30A of the State Sector Act 1988.

11 Canterbury Earthquake Recovery Act 2011, s 3(c).

12 Cabinet Minute "Land Damage from the Canterbury Earthquakes" (27 June 2011) CAB Min (11) 24/15.

13 At [2.9]–[2.24].

[16] The O'Loughlins accepted CERA's option two, agreeing to sell the land to the Crown for $110,000, payable under s 19 of the ECA. They signed an agreement for sale and purchase with the Crown on 21 May 2012, and are now contractually obliged to settle and leave their home on 31 July 2013. Thus, as a consequence of the O'Loughlins accepting option two of the CERA red zone offer, they will on settlement receive $110,000 for their land. This being for the land as distinct from the building, both sides accept that it is not deducted from the amount claimed from Tower.

Pleadings and issues

[17] The second amended statement of claim sets out details of the policy and asserts that the O'Loughlins' house is a total loss. It is claimed that it could have been rebuilt on the current site to the same condition and extent as when new for $620,000. The plaintiffs seek a declaration that the defendant is liable to pay $416,113.50, which is that sum less the $203,886.50 received from the EQC, or alternatively judgment for that sum and general damages of $50,000. It is claimed that the defendant has refused to meet its contractual obligations to pay this amount.

[18] The defendant in its statement of defence admits that the plaintiffs' house suffered natural disaster damage as a result of the Canterbury earthquakes in September and February. It pleads that it has met its obligations under the policy by offering to pay $137,739 in settlement, being the original repair costs calculated by Tower of $341,625.74, less the EQC payments under s 19 of $203,886.50. That position has now changed. Tower now accepts that the cost of repair is the higher sum of $390,000. It has now paid during the trial and the O'Loughlins have received (without prejudice to their higher claim) the sum of $197,179.15.

[19] Thus, the difference between what the O'Loughlins seek and Tower has paid is $218,934.35.

[20] The parties have been asked to provide an agreed list of issues. They have not been able to do so but both have filed their own list. There are considerable discrepancies between each. On my analysis, the four broad issues are:

(a) Has the creation of the red zone caused loss or damage to the O'Loughlins' house so that irrespective of physical damage, Tower is obligated to provide full replacement cover?

(b) Has Tower met its obligations under the policy by offering a payment (and now making a payment) to the O'Loughlins for a sum equivalent to the cost of repairing the house, adopting the LMG technique?

(c) If Tower has not fulfilled its contractual obligations in offering and making the payment based on the notional cost of repairs, what sum should it now pay, and calculated on what basis?

(d) If Tower is in breach of contract, should the O'Loughlins receive an award of general damages?

[21] The parties have agreed that:

(a) the payments by the EQC of $203,886.50 is a proper deduction from the O'Loughlins' claim in terms of the policy;

(b) the later offer by CERA to pay $110,000 for the land would not be a proper deduction;

(c) the cost of repairing the house by the LMG method proposed by Tower is $390,000;

(d) the cost of rebuilding an equivalent house on a site where the land was sound and unaffected by the earthquakes is $540,000; and

(e) the cost of rebuilding the house on the existing red zone site is $620,000.

Did the creation of the red zone engage the policy?

The red zone

[22] On 20 June 2011, Cabinet granted a Power to Act to a group of Ministers, to allow them to "take decisions on matters relating to Canterbury earthquake land damage and remediation issues".[14] A Power to Act is granted by Cabinet to allow certain members of Cabinet to act on its behalf. Such action is usually taken where there is a limited time period within which decisions can be made that would otherwise require Cabinet approval.[15]

[23] On 22 June 2011, Cabinet met to discuss a new Cabinet paper submitted by the Christchurch Earthquake Recovery Minister Hon Gerry Brownlee.[16] That paper includes the details of proposed zones, including the red zone. In the Cabinet papers Tonkin and Taylor, an environmental and engineering consultancy firm, was quoted as having described the red zones as being areas where:[17]

> Land repair would be prolonged and uneconomic
>
> - Land has suffered significant and extensive damage
> - Most buildings are uneconomic to repair
> - There is a high risk of further damage to land and buildings from low-levels of shaking (e.g. aftershocks), flooding or spring tides
> - Infrastructure needs to be completely rebuilt
> - Land repair solutions would be difficult to implement, prolonged and disruptive for landowners[.]

[24] The paper reads:[18]

> In the **Red Zones**, rebuilding may not occur in the short-to-medium term because the land is damaged beyond practical and timely repair, most

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14 Cabinet Minute "Additional Item: Canterbury Earthquake: Land Damage and Remediation Issues: Power to Act for Group of Ministers" (20 June 2011) CAB Min (11) 23/19.

15 Cabinet Office "Power to Act" CabGuide: Guide to Cabinet and Cabinet Committee Processes <www.cabguide.cabinetoffice.govt.nz/definitions/power-to-act>.

16 Gerry Brownlee "Memorandum for Cabinet: Land Damage from the Canterbury Earthquakes" (22 June 2011).

17 At [42].

18 At [10].

> buildings are generally rebuilds, these areas are at high risk of further damage to land and buildings from low-levels of shaking (e.g. aftershocks), flooding or spring tides; and infrastructure needs to be rebuilt.

[25] In the same Cabinet paper under the heading "What does this mean for landowners and businesses?", it is stated that the red zones are not likely to be practicable for rebuilding in the short to medium term.[19] It is suggested that the decision to identify areas as red zones allows the landowners in those areas to move on and make decisions about their future.[20] It is also stated:[21]

> For these Red Zone areas, the time required to assess the land and design engineering solutions carries undue risks for the occupants of the land. There are risks around likely further land damage, the uncertain nature of the future plans for these areas and the ongoing social impact of fractured or displaced communities. The Government has determined that it is neither practical nor reasonable for these communities to stay in the Red Zone areas during the extensive time required to fully design remediation solutions.

[26] The material later forwarded to homeowners in a document issued by the Minister for Canterbury Earthquake Recovery and the Chief Executive Officer of CERA contained an introductory message from the Minister for Canterbury Earthquake Recovery: "… [red zone] land is unlikely to be suitable for residential occupation for a considerable period of time." The document stated:

> **What will happen to my property if I decide that I do not want to accept the Crown's offer?**
>
> If you decide that you do not want to accept the Crown's offer, you should be aware that:
>
> - The Council will not be installing new services in the residential red zone.
>
> - If only a few people remain in a street and/or area, the Council and other utility providers may reach the view that it is no longer feasible or practical to continue to maintain service es to the remaining properties.
>
> - Insurers may cancel or refuse to renew insurance policies for properties in the residential red zones.
>
> - While no decisions have been made on the ultimate future of the land in the residential red zones, CERA does have powers under the Canterbury Earthquake Recovery Act 2011 to require you to sell your property to CERA for its market value at that time. If a decision is made in the

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19 At [73].
20 At [72].
21 At [74].

> future to use these powers to acquire your property, the market value could be substantially lower than the amount that you would receive under the Crown's offer.

[27] Given the breadth of submissions I have received, I set out what the red zone did not do:

(a) It did not prohibit building or the granting of building consents in the area for repair or rebuilding.

(b) It did not prohibit residents from continuing to live in the red zone.

(c) It did not require residents to demolish or repair their houses.

[28] In terms of what the creation of the red zone did do, it created an area in which CERA would make offers to purchase the properties of insured residents. Apart from that specific measure, the creation of the red zone was accompanied by a statement by the Government of its assessment of the problems and risks of living there. On an overview it gave notice that red zone land:

(a) had suffered significant and extensive damage;

(b) had buildings most of which were uneconomic to repair;

(c) was at high risk of further damage to land or buildings from shaking, flooding or spring tides;

(d) was in a condition where it was neither practical nor reasonable for the communities to stay there while solutions were sought;

(e) would not have new services installed by Councils;

(f) might, if Councils or utility providers reached the view that services were no longer feasible or practical, have services discontinued;

(g) is land where insurers may cancel or refuse to renew insurance policies; and

(h) may be subject to compulsory acquisition by the Crown at market value, which could be substantially lower than the amount of the CERA offer.

[29] I emphasise that the creation of the red zone cannot be seen in isolation from the Cabinet decision that was made at the same time, to offer to buy the homes of residents for their 2007 valuation, or the section value alone. The red zone measure did not render the O'Loughlins' home valueless; to the contrary, it gave their house a value that, depending on what had happened to Christchurch values between 2007 and 2010 (and there is no evidence on the point), could have been the same as its value at the time of the earthquake. At this point their house is still insured by Tower, and has services.

[30] Following the creation of the red zone, there were a number of direct consequences. Tower took the view that it could not perform the repairs and expressly said so in its communications to the O'Loughlins. While Mr Galbraith QC observed that this view might have been legally incorrect, Tower's attitude to repair reflects the significant change effected by the red zone designation, and the view of Tower that the house could no longer be repaired. Further, the O'Loughlins no longer wished to live there. There are now only two houses occupied out of the 90 previously in their neighbourhood. It can be readily appreciated how the O'Loughlins see the earthquakes and the red zone as having taken away their neighbourhood. Tower has acknowledged throughout that it would be unreasonable to expect the O'Loughlins to continue living there in the long term, given the designation.

Approach to interpreting the policy

[31] It is agreed that the physical damage caused by the earthquakes to the O'Loughlins' house is covered by the policy. The first issue is whether the

declaration of the red zone that followed the earthquakes engaged the full replacement cover under the policy, irrespective of the physical damage to the house.

[32] Mr Shand submits that the policy was engaged by the red zone designation, which, in his submission, has rendered the O'Loughlins' home uninhabitable. As I understand it, he put this claim under the policy in general terms, both as a claim under the primary insurance clause of the policy, and also as a claim under the natural disaster special benefit. Mr Galbraith for Tower submits that the policy does not insure under either head against a Government measure that does not directly physically affect the house.

[33] This is a contract case. It is common ground that the contract document is the Tower Provider House Policy in its current form. Like many contract cases, resolution of the dispute involves both an assessment of the contractual obligations of the parties, and an analysis of factual evidence to see whether those obligations have been met or breached.

[34] The starting point must be the words of the policy. It is a policy worded in the new form, without paragraph numbers and without the long sentences and paragraphs that were features of insurance policies in the past. While the policy does not have paragraph numbers it has page numbers, headings and bullet points, and these will be the reference points in the course of this judgment. It has an introductory section, a statement of what is and is not insured, a statement of what Tower will pay if there is an accident that engages the policy, and a definitions section.

[35] In New Zealand, insurance contracts are interpreted in the same way as all other contracts. There are no special rules that apply. Thus, the initial focus is on the words and the plain meaning. The context of the words in the policy and the matrix of surrounding facts are also relevant to the process of interpretation. While it makes sense to start with the actual words of the contract, there is no presumption in favour of ordinary meaning. A meaning that appears plain and unambiguous when devoid of context may not ultimately be what the parties intended when

considered in that context and other relevant circumstances.[22] The doctrine of contra proferentem by which a Court may resolve a clear ambiguity against the party who prepared the contract can be applied.[23]

[36] So I must strive to interpret the policy in a way that correlates with the presumed mutual intention of the parties, construed objectively. The parties' views as to what they subjectively thought and intended are irrelevant[24] and I record that I put to one side the O'Loughlins' statements about what sort of cover they thought they had.

Tower's obligation

[37] Under the policy, Tower assumes an obligation to the insured to arrange payment, rebuild, replacement or repair for loss and damage that is caused.[25] The insured is promised that Tower will pay either:

> - the **full replacement value** of **your house** at the **situation**; or
> - the **full replacement value** of **your house** on another site **you** choose. This cost must not be greater than rebuilding **your house** at the **situation**; or
> - the cost of buying another house, including necessary legal and associated fees. This cost must not be greater than rebuilding **your house** on its present site; or
> - the **present day value**[.]

[38] Full replacement value is defined as:[26]

> **Full replacement value** means the costs actually incurred to rebuild, replace or repair **your house** to the same condition and extent as when new and up to the same area as shown in the **certificate of insurance**, plus any decks, undeveloped basements, carports and detached domestic outbuildings, with no limit to the sum insured.

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22 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [4] (Blanchard J), [24] (Tipping J) and [77] (McGrath J); and *Trustees Executors Ltd v QBE Insurance (International) Ltd* [2010] NZCA 608, (2010) 16 ANZ Insurance Cases 61-874 at [33].

23 *D A Constable Syndicate 386 v Auckland District Law Society Inc* [2010] NZCA 247, [2010] 3 NZLR 23 at [69]–[70]; *Trustees Executors*, above n 22, at [39].

24 *Vector Gas*, above n 22, at [19] (Tipping J), [14] (Blanchard J) and [76] (McGrath J).

25 Tower Insurance Ltd "TOWER Provider House Policy: Maxi Protection" [Policy] at 11.

26 At 15.

[39] The option to decide whether Tower makes payment, rebuilds, replaces or repairs the insured's home is stated to be with Tower.[27] Once Tower makes that election, the obligation is on Tower to carry that out. There is no reference to it being at Tower's option whether to pay "the present day value". "Present day value" is defined, and is in essence the indemnity value of the house (and thus limited to market value taking into account depreciation), rather than replacement value (which provides for an "as when new" replacement).

Claim under the primary insurance clause of the policy

[40] The policy relates to damage to the house. It does not cover damage to the land. Directly after the contents page of the policy, there is a heading "What your house is insured for" under which it is stated that the policy will cover:[28]

> Sudden and unforeseen accidental physical loss or damage unless excluded by this policy.

[41] I will refer to this as the "primary insurance clause". The policy then goes on to set out special benefits that an insured is insured for, and to state a number of exclusions for which the insured is not covered.

[42] In considering the O'Loughlins' claim that the red zoning engaged this primary insurance clause, the individual words in the phrase "accidental physical loss or damage" must each be weighted. Of the two adjectives, "physical" deserves special emphasis. The O'Loughlins' house has in fact suffered physical damage, particularly in the warping of the concrete base. The insurance contract explicitly provides for replacement cover against such loss, as will be considered later in this judgment.

[43] But can the event of the creation of the red zone after the earthquakes fall within the definition of sudden and unforeseen accidental physical loss or damage? The word "physical" means "of or concerning the body",[29] and in the context of the

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[27] At 11.
[28] At 5.
[29] Tony Deverson and Graeme Kennedy (eds) *The New Zealand Oxford Dictionary* (Oxford University Press, Auckland, 2008) at 852.

insurance of a house from loss or damage from accident, plainly means loss or damage to the materials and structures that constitute the body of the house. In *Guardian Assurance Co Ltd v Underwood Constructions Pty Ltd*,[30] the cost of remedial work by an insured fell within the definition of "damage to property", as "damage" was held to include disturbance of the "physical integrity" of the subject property. The red zone designation did not cause any damage to the physical integrity of the O'Loughlins' house. The creation of the red zone itself did not have any physical effect on anything; rather, it affected the way in which land and houses might be regarded in a particular area, and gave property owners in the zone an option to sell to the Crown.

[44] The requirement for "physical loss" has often been in issue in insurance cases. While cases must always turn on the terms of the particular policy and the context in which they arise, it is fair to say that the need for some type of disturbance to the physical integrity of the subject property itself has been treated as a requirement in many cases.[31] Thus, in *Moore v Evans* Lord Atkinson said that the expression "damage to property" must mean "physical injury".[32]

[45] In *Pilkington United Kingdom Ltd v CGU Insurance plc*,[33] defective glass panels were installed in a building that required remedial work to eliminate a risk of them fracturing and causing injury. The liability policy of the plaintiffs insured against "[l]oss of or physical damage to physical property not belonging to the Insured."[34] It was held that installation of the faulty glass panels did not qualify as physical damage and consequently was not covered by the policy, and that any loss arising from the risk that subsequent personal injury might occur was potential economic loss and not loss of or physical damage to physical property.[35]

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30 *Guardian Assurance Co Ltd v Underwood Constructions Pty Ltd* (1974) 48 ALJR 307 (HCA) at 309.

31 *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd* (1987) 4 ANZ Insurance Cases 60-772 (QSC); *Guardian Assurance*, above n 30; and *Bayer Australia Ltd v Kemcon Pty Ltd* (1991) 6 ANZ Insurance Cases 61-026 (NSWSC).

32 *Moore v Evans* [1918] AC 185 (HL) at 191.

33 *Pilkington United Kingdom Ltd v CGU Insurance plc* [2004] EWCA Civ 23, [2005] 1 All ER 283.

34 At [8].

35 At [49], [51] and [53].

[46] The Court declined to follow a line of United States of America authority that stood for the proposition that the incorporation of a defective but nonetheless operative item into a building gave rise to physical damage in the ordinary sense. It was held "in English law, 'damage' usually refers to a 'changed physical state'",[36] relying on *Promet Engineering (Singapore) Pte Ltd v Sturge, (The "Nukila")*.[37] The Court in *Pilkington* went on to hold:[38]

> As already observed, generally speaking damage requires some altered state, the relevant alteration being harmful in the commercial context.

[47] Mr Shand referred to United States cases where it has been held that where a product has become unsaleable because of an event that may or may not have damaged the goods, but which has in any event led to a regulatory response that rendered it unsaleable, damage has occurred.[39] Indeed, those authorities go so far as to suggest that this can be physical damage.[40]

[48] There is a similar line of cases that indicates that when a property suffers no damage but becomes subject to a potential threat, for instance falling rocks or landslides, this is treated as being physical damage.[41] The fact that a structure cannot be used as a dwelling in the sense that rational persons would be content to reside there, is relevant to the conclusion that there must be damage.

[49] I do not consider these authorities of assistance in the New Zealand context. In *Pilkington*, the English Court of Appeal did not adopt a line of United States authority in which an interpretation of physical damage more generous to the insured was adopted.[42] I also note Stuart-Smith LJ's observations in *Yorkshire Water Services Ltd v Sun Alliance & London Insurance plc*[43] concerning the significant

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36 At [50].

37 *Promet Engineering (Singapore) Pte Ltd v Sturge (The "Nukila")* [1997] 2 Lloyd's Rep 146 (CA) at 151.

38 At [51].

39 *Marshall Produce Co v St Paul Fire & Marine Insurance Co* 98 NW 2d 280 (Minn 1959).

40 *General Mills Inc v Gold Medal Insurance Co* 622 NW 2d 147 (Minn 2001).

41 *Hughes v Potomac Insurance Co* 199 Cal App 2d 239 (DC 1962) and *Murray v State Farm Fire and Casualty Co* 509 SE 2d 1 (WV 1998).

42 *Pilkington*, above n 33, at [36].

43 *Yorkshire Water Services Ltd v Sun Alliance & London Insurance plc* [1997] 2 Lloyd's Rep 21 (CA) at 28.

differences in approach between English and United States' courts in interpreting insurance contracts.

[50] The United States cases above discussed extend coverage from damage or loss of a physical kind to impairment of use or detriment of value of property; a significantly wider net of liability. While the events in those cases, be they landslides, fires, or spread of pesticides, had economic consequences for physical property, they did not cause those consequences by physical damage or loss to the property itself. It is also significant that the "potential threat" cases may in any event not be relevant to the red zone issue, as threats of rocks or landslides are direct threats to the physical integrity of a building, and of a different nature to a public measure such as the creation of the red zone.

[51] I do not consider the doctrine of contra proferentem can be used to assist the interpretation put forward by Mr Shand. The red zone designation caused no physical damage and there is nothing in the context or background circumstances to suggest a different interpretation. There is no ambiguity.

[52] I turn to the meaning of the word "loss". It is a broad word and often is construed as meaning physical loss.[44] I have not been referred to any cases that have determined that the word "loss" in a building insurance policy can mean economic loss. In the case of *Graham Evans & Co (Qld) Pty Ltd v Vanguard Insurance Co Ltd*,[45] the insured agreed to erect a building. Before it was completed it was discovered that a number of significant errors had been made in the spacing and location of columns and walls. The policy insured against all risk of physical loss or damage. It was held that "physical loss" implied possession of property, followed by loss of possession.[46] The word "loss" in the context of this policy can be seen as meaning the total destruction of a building as distinct from damage to the building. The total destruction is a physical injury. There still must be a physical event in relation to the building before there is a loss.

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44 *Technology Holdings Ltd v IAG NZ Ltd* (2009) 15 ANZ Insurance Cases 61-786 (HC); and *Holmes v Payne* [1930] 2 KB 301 (KB).

45 *Graham Evans*, above n 31.

46 The same conclusion was reached in *Technology Holdings*, above n 44, at [22]–[30] in relation to a business assets insurance policy.

[53] The red zone measure did not cause the O'Loughlins' house to suffer loss in this sense. The house is not only physically unaffected, but it is not indirectly affected in the sense of being deprived of water or electricity or other services. The house remains exactly the same, has its services, and can be inhabited.

[54] I conclude that the red zone designation did not cause physical loss or damage to the O'Loughlins' house under the primary insurance clause.

Claim under the natural disaster damage special benefit clause

[55] After the clause setting out the primary obligation on the insurer to insure against accidental physical loss or damage, there is a heading "What special benefits you are insured for".[47] The special benefits are, at the start of the policy, referred to as "extra cover".[48]

[56] There are 10 subheadings under that heading, which detail the "extra cover". One of them is "Natural disaster damage". Under that it reads:[49]

> If **your house** suffers **natural disaster damage, we** will pay the difference between the amount paid under EQCover and the sum insured shown in the **certificate of insurance**.

[57] It is stated at the beginning of the policy that some words are in bold, and this may indicate that the words have a special meaning, set out under the heading later in the policy "Meaning of words".[50] Under that heading natural disaster damage is defined as follows:[51]

> ***Natural disaster damage*** *means loss or damage as a direct result of earthquake*, **natural landslip**, volcanic eruption, hydrothermal activity or tsunami *and includes loss or damage occurring (whether accidentally or not) as a direct result of measures taken under proper authority to avoid the spreading of, or to otherwise reduce the consequences of, an earthquake,* **natural landslip**, volcanic eruption, hydrothermal activity or tsunami. It does not include any loss or damage for which compensation is payable under any Act of Parliament other than the Earthquake Commission Act 1993.

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47 Policy, above n 25, at 5.
48 At 1.
49 At 5.
50 At 14.
51 At 15.

(emphasis added in italics.)

[58] There is no question as to the O'Loughlins having suffered natural disaster damage as a direct result of earthquake. Indeed, this is expressly admitted by Tower in its statement of defence. The special benefit is therefore engaged and the wording applies.

[59] The question is whether in terms of the definition of natural disaster damage, the O'Loughlins, through the creation of the red zone (as distinct from the earthquakes), have suffered loss or damage "as a direct result of earthquake … occurring whether accidentally or not as a direct result of measures taken under proper authority to avoid the spreading of, or to otherwise reduce the consequences of, an earthquake …". Mr Shand argues that the special benefit applies. Mr Galbraith submits that it does not.

[60] I have no doubt that the creation of the red zone was "a measure" under the clause. The red zone was decided by Cabinet and implemented by CERA through its communication with property owners and the resulting offers to buy red zone properties. It was followed by statements from the Minister for Canterbury Earthquake Recovery and the Chief Executive Officer of CERA explaining the red zone and the Crown's offers. This was a "measure" in the sense of it being "a suitable action to achieve an end".[52]

[61] As with "measure", the phrase "proper authority" is unique to the natural disaster special benefit. In this context, the "authority" referred to must be the source of power under which the person or entity is acting when its actions result in the damage or loss. I have no doubt that the Cabinet decision to declare a red zone and the steps taken by CERA to communicate that decision to occupiers of the red zone and make offers to them, were measures taken under "proper authority".

[62] The measure must be "to avoid the spreading of, or to otherwise reduce the consequences of an earthquake". After the earthquakes, home owners in the most severely affected parts of Christchurch faced a most uncertain future, and the

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[52] *The New Zealand Oxford Dictionary*, above n 29, at 698.

dilemma of whether they should stay and repair or rebuild or replace elsewhere. A review of the Cabinet papers shows that Cabinet decided to create the red zone to provide relief to residents in the worst affected areas from this uncertainty. Cabinet decided that it was not practicable or reasonable to expect residents to stay on in the areas that were to be covered by the red zone. It is clear that the creation of the red zone and the offer to purchase were, in combination, a measure taken to reduce the consequences of the earthquakes.

Is the natural disaster cover limited to physical damage?

[63] Mr Galbraith in his submissions did not contest whether the declaration of the red zone was a measure taken under proper authority to avoid the spreading or otherwise reduce the consequences of the earthquakes. His submission was aimed at the phrase "loss or damage as a direct result of earthquake". He argued that the "loss or damage" was physical loss or damage to the house, and the red zone measure itself had not given rise to such loss or damage. Mr Shand contended that the absence of the word "physical" in the natural disaster damage definition meant that damage by diminution in value was covered, and there was no requirement of physical damage.

[64] I have referred to the primary insurance clause and the qualifying word "physical" before "loss or damage". That word is not used in the numerous other references to "loss or damage" in the policy. Those words stand alone without the adjective "physical". Thus, under the special benefits headings of "Gradual damage", "Landscaping", "One event – one excess", "Property security after loss", and "Temporary accommodation expenses,"[53] the phrase "if your house suffers loss or damage …" starts the paragraph and the word "physical" does not qualify the words.

[65] However, in those clauses the loss or damage in context can only be physical loss or damage. Thus under the "Gradual damage" special benefit it is through gradual "deterioration, mildew, mould or rot". Under "Landscaping", it is loss or damage as a result of fire or impact. In these, and with the later references to loss or

[53] Policy, above n 25, at 5–6.

damage, the context indicates physical loss or damage. Some of the special benefits go further than covering physical loss or damage such as the "Keys and locks" and "Temporary accommodation expenses" benefits, but the particular cover is there spelled out and has no reference to loss or damage to the building.

[66] This is an indication that the initial definition of "physical" loss or damage sets the scene, and that later references to loss or damage import the same concept as the primary insurance clause. The presence of the word "physical" is assumed because it is in the primary insurance clause.

[67] The section in the policy headed "How we will settle your claim"[54] refers only to payments for replacement by repair, rebuild, or buying another house, or present day value. That value is the cost at the time of the loss or damage of rebuilding, replacing, or repairing the house back to market value. These payment options naturally apply to physical as distinct from economic damage to the house. An indemnity for non-physical loss would require a different wording, involving the insurer paying for loss to the economic value of the house rather than its repair, rebuild or replacement cost. If there was such cover, the payment options could be expected to include a calculation for economic loss. The payments referred to in this section are payments in lieu of repair, rebuild or replacement, or the cost of those on a present day value basis, but not for compensation for economic losses unrelated to physical damage.

[68] In arguing that natural disaster damage was physical damage, Mr Galbraith gave the example of a house in the red zone having an undamaged wall which, for earthquake related reasons, was in danger of falling down, imperiling passersby. A measure by a proper authority directed at the removal of such a wall would be the sort of action covered by the natural disaster special benefit, as it would have a physical effect on the house.

[69] The loss or damage that has occurred as a consequence of the creation of the red zone is summarised by Mr Shand in his submissions as follows:

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[54] At 11.

(1) Tower having the view that it could not perform the repairs because the property was in the "red zone";

(2) Tower deciding not to repair the house;

(3) CERA acquisition offers – at less than rebuild costs. In the O'Loughlins" case the sum offered for their house in the CERA offers was $310,000. The agreed rebuild costs are $620,000;

(4) Houses being acquired and demolished. CERA has agreed to acquire the O'Loughlins' house and will demolish if after 31 July 2013;

(5) Essential services to areas being reduced/eliminated;

(6) No insurance cover is obtainable for a red zone house;

(7) The real risk CERA compulsorily acquires the house;

(8) Ultimately the loss of the O'Loughlins' house.

[70] These items (not all of which accurately summarise effects of the creation of the red zone) do not involve loss or damage to the O'Loughlins' house. They are effects which may have economic consequences to the value of the house.

[71] Also contained in the policy is an exclusion for loss or damage arising from confiscation, nationalisation or acquisition by an order of Government, local authority, the Courts, or any public authority "unless it is to prevent loss or damage covered by this policy".[55] Mr Galbraith argued that if the red zone measure was covered under the natural disaster special benefit, that was inconsistent with the lack of cover for confiscation. He argued that if confiscation itself was not covered, then any loss that flows from the threat of confiscation should not be either. I accept that submission. It would be surprising if the policy contemplated the Government exercising a measure that was less than confiscation as triggering full cover, while full confiscation would not. It could mean that whether the policy was engaged would turn on how the Government promulgated a measure, and could leave the insurer vulnerable to the exclusion being nullified by an event that was in the control of a third party.

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[55] At 10.

Authorities

[72] I have already referred to the case law which approaches the issue of loss or damage to property on the basis that there must be some disturbance to the physical integrity of the subject property.[56] Those decisions did not turn on the presence of the word "physical". However, Mr Shand relied on a number of authorities for the proposition that given the absence of the word "physical" in the natural disaster damage special benefit, loss or damage did not need to be physical loss. He relied on *Kelly and Ball Principles of Insurance Law* where it is stated after reviewing Australian and New Zealand case law:[57]

> Where the word "damage" is not qualified by the word "physical", it is normally sufficient if the damage is in the form of diminution in value or functionality.

The particular case cited in support of this proposition is *Ranicar v Frigmobile Pty Ltd*.[58] In *Ranicar*, scallops had been stored at a temperature of approximately -6 degrees rather than the required -18 degrees.[59] The temperature variation was accepted as involving some physical change to the scallops due to a different enzymic activity and chemical oxidation of fats at the different temperatures.[60] Green CJ identified the loss as arising out of the inability to export the scallops, caused by the view taken by the relevant authorities that because they were stored at the warmer temperature they should not be exported. He observed: "As a result, it is plain that the usefulness was impaired and the value reduced."[61]

[73] In that case, Green CJ reviewed the case law as to the meaning of damage, and considered that the prima facie or ordinary meaning of the word when used in relation to goods involved some physical alteration or change. He could see no reason to depart from that meaning. He decided that the change in temperature amounted to damage to the scallops, as a change in temperature involves physical change to a substance.

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56 See above at [43]–[52].
57 Michael Ball and David Kelly *Kelly and Ball Principles of Insurance Law* (Butterworths, New South Wales, 2001) at [12.0050.15].
58 *Ranicar v Frigmobile Pty Ltd* (1983) 2 ANZ Insurance Cases 60-525 (TASSC).
59 At 77,998.
60 At 78,001.
61 At 78,001.

[74] In *Technology Holdings Ltd v IAG New Zealand Ltd*,[62] Woodhouse J had to consider whether there was damage under an insurance policy to eftpos terminals following flooding. The terminals had not been directly affected by the water, but because they had been stored in an area where there had been floodwater, they had lost their warranty and the network operator refused to permit connection to those terminals.[63] The policy was a business assets insurance policy. He concluded that the fact that the terminals had been rendered not fit for their intended use by the flooding meant that there had been "damage to the property" in terms of the policy, even though the units were not physically damaged.[64] He applied *Ranicar* and the summary in *Kelly and Ball*. However, he noted that a diminution in value or functionality was not, on its own, damage in terms of the policy. If it was, any loss suffered by an insured party in respect of property no matter what the cause, would potentially be covered.[65] He noted that policies of that type were not policies of insurance against pure economic loss, and that something must happen to the property itself for damage to occur.

[75] It is not necessary to analyse the facts of *Ranicar* and *Technology Holdings Ltd* further as they related to different types of policies and the wording and context within the policies were very different from the present. But on an overview, they do not support Mr Shand's submission that the purely economic consequences of the creation of the red zone were loss and damage in terms of the policy. Indeed, the weight of authority is in my view against Mr Shand's submission. In both *Ranicar* and *Technology Holdings* and the cases relied on in those instances, the need for some physical change to the subject matter of the insurance was referred to. In this case, the O'Loughlins' house did of course suffer physical damage in the earthquakes. But unlike the events that affected the scallops or eftpos terminals in *Ranicar* and *Technology Holdings*, earthquake damage or events relating to the O'Loughlins' house in particular did not lead to the creation of the red zone. The zone would have been declared even if their house had suffered no damage at all. It was the general damage to the land in the whole red zone area, and the uncertainty as to the future of residential occupation that was the cause.

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62 *Technology Holdings Ltd v IAG New Zealand Ltd*, above n 44.
63 At 77,139.
64 At 77,149.
65 At 77,149.

[76] Mr Shand pointed out that the wording of the natural disaster damage special benefit is very close to the wording of the definition of "natural disaster damage" in the ECA.[66] That definition reads:

> **Natural disaster damage** means, in relation to property,—
>
> …
>
> (b) Any *physical* loss or damage to the property occurring (whether accidentally or not) as a direct result of measures taken under proper authority to avoid the spreading of, or otherwise to mitigate the consequences of, any natural disaster, but does not include any physical loss or damage to the property for which compensation is payable under any other enactment:
>
> (emphasis added.)

[77] He submitted that the fact the word "physical" is used in the definition in the ECA, and not used in the definition of the policy, is an indication that its deletion is deliberate.

[78] He also raised the contra proferentem rule. He submitted that there is ambiguity in relation to whether natural disaster damage includes a Government measure that does not relate to a physical attribute of the house, but rather to its useability and value. The clause was drafted by Tower and the interpretation that favours the insured should be applied. He also relied on the factual matrix. The front page of the policy describes the policy as providing "maxi protection", and there is reference to the house being "your castle". It is a replacement policy, replacement value not being an extension but the primary obligation.[67] There is reference to the insured having "entrusted" Tower with the insurance of their house, and to that trust being valued.[68] There are also a number of references to providing "full replacement value" of the house.[69]

[79] These submissions are not persuasive. The difference between the definition in the ECA and that in the policy may reflect no more than a drafting decision that the parameter of loss and damage, being physical loss or damage, was established in

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66 Earthquake Commission Act 1993, s 2.
67 Policy, above n 25, at 11.
68 At 1.
69 At 6, 11, 12 and 15.

the primary insurance clause. The contra proferentem principle is only an aid to interpretation. It is not a rule that can overcome a clear contextual indication of meaning. For the reasons given,[70] I consider that the context shows that the cover is for physical loss or damage. It would do violence to the words in the payment section to read in the obligation to pay a cash sum reflecting economic loss.

[80] Looking at the wider commercial context, it would be surprising if a public measure that caused no direct physical consequences to a house could be accepted as causing loss or damage to the house in an insurance context. All sorts of public measures can have economic consequences. A declaration following an earthquake that a particular type of cladding should be used no longer, or a regulation changing traffic flows, or a zoning announcement, could all have an economic effect on the value of a house. Such an interpretation would expose an insurer to claims that are not normally subject to house insurance cover, and which would be most difficult to quantify.

[81] Mr Shand strongly submitted that the O'Loughlins were entitled to replacement cover following creation of the red zone, because this was their reasonable expectation of the cover they thought they had purchased. He relied on two articles from United States law journals supportive of the existence of a reasonable expectations doctrine in the United States.[71]

[82] However, there is no case where a reasonable expectations doctrine has been applied in New Zealand for the interpretation of insurance policies. Further, as noted above, in *Yorkshire Water Services Ltd v Sun Alliance and London Insurance plc*[72] Stuart-Smith LJ took the view that American courts were more benign in their attitude towards insureds, reflecting a substantial element of public policy which is not part of the principles of construction of contracts under English law. In New

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70 See above at [63]–[71].

71 Eugene Anderson and James Fournier "Why Courts Enforce Insurance Policyholders' Objectively Reasonable Expectations of Insurance Coverage" (1998) 5 CTILJ 335; and Hugh Wood "The Insurance Fallout Following Hurricane Andrew: Whether Insurance Companies Are Legally Obligated to Pay for Building Code Upgrades Despite the 'Ordinance or Law' Exclusion Contained in Most Homeowners Policies" (1993) 48 U Miami L Rev 949.

72 *Yorkshire Water Services*, above n 43. See also a useful discussion in John Lowry, Philip Rawlings and Robert Merkin *Insurance Law Doctrines and Principles* (3rd ed, Hart Publishing, London, 2011) at 265–269.

Zealand, the words of the contract are the initial focus. The background matrix of facts is used to assist in establishing meaning but does not assume primacy.[73] On Mr Shand's submission I could put the actual words to one side, and interpret the policy in accordance with the cover that insureds thought they were getting. That is not the way in which contracts are interpreted, and I do not think the reasonable expectations doctrine has a place in New Zealand law.

[83] For these reasons I conclude that the natural disaster special benefit does not include cover for economic loss.

In any event, is there economic loss?

[84] Mr Shand in his submissions assumed that if the creation of the red zone was natural disaster damage, the consequence was that Tower must pay for a rebuild off-site, calculated on the basis of the cost of building on the present site. Given that the red zone does not require the O'Loughlins to do anything to their house, the loss or damage arising from its creation must be economic loss that has to be proven. In fact, no evidence was adduced by the O'Loughlins to prove that economic loss.

[85] It is not clear that the creation of the red zone indeed caused any economic loss, coupled as it was with the CERA offer to buy at the 2007 valuation. I have no evidence from the O'Loughlins on loss of value. I note that the value given to the O'Loughlins' house on the CERA offer was $310,000, and the value attributed to the house by Tower's valuer Mr Shalders (and not challenged by the O'Loughlins) before the earthquake on 3 September 2010 was $258,000. On those figures, the 2010 value of the house was less than the 2007 value, which might be explained by the drop in values following the general financial crisis. If that calculation were correct, the O'Loughlins could have become better off as a consequence of the red zone than before its creation (although there would have to be consideration of Tower's obligation to rebuild or replace with a house "to the same condition and extent as when new", which allows the O'Loughlins to be paid on the basis of an as when new house).[74] What is clear is no evidence has been adduced to show that the

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[73] *Vector*, above n 22, at [19] and [23].
[74] See discussion at [173]–[182] below.

creation of the red zone has caused economic loss or damage to the value of the O'Loughlins' house.

[86] The claim to loss or damage arising from the creation of the red zone under the natural disaster special benefit therefore fails.

Is payment based on the repair estimate using LMG calculated in compliance with Tower's contractual obligations?

Introduction

[87] It is now necessary to turn to the second broad issue, whether under the general cover provisions, Tower is able to pay the O'Loughlins based on the cost of a LMG repair or rather, as the O'Loughlins claim, Tower is obligated to pay on the basis of a rebuild. It is argued for Tower that the LMG option is an appropriate repair method that would be approved by the Council. The O'Loughlins submit that there are considerable risks involved in the LMG method, and it would not comply with the building code or be repaired to the contractual standard.

Context of the disagreement

[88] Following the earthquakes, Tower engaged Stream Group New Zealand (Stream) to assist it in processing claims. Stream Group, as it was referred to throughout the hearing, is a specialist claims management company based in Australia that provides loss adjusting and project management services. It has been engaged by various insurance companies throughout Australia and New Zealand in relation to losses. It has established a Christchurch office and its project team manager in that office is Mr Michael O'Leary, who gave evidence.

[89] Stream first inspected the property after the first earthquake on 22 September 2010, and was involved in assessing damage on the site thereafter. It presented reports on 3 February 2011 and 5 August 2011. The initial report stated that the dwelling had suffered "significant cracking and differential settlement", and there was "limited construction technology available to remediate this type of damage on

liquefied ground". The report recommended engineering advice as to the feasibility of a "hypothetical repair option", and in considering reinstatement options noted a cost to rebuild of $426,000 and an estimated repair cost of $184,046. It recorded that the dwelling was technically repairable if the slab could be "jacked up economically".

[90] The report described as the "assessor's first report" was sent by Tower to the O'Loughlins on 8 August 2011. By this time, Mr David Ashe, a witness called by Tower, had been appointed as manager of Earthquake Recovery for Tower. This initial report was stated to be only a "very high level preliminary estimate" and "not an indication of the costs of resolving" the claim. It was stated that the final findings and costs could change quite significantly.

[91] Stream engaged Relevel, a joint venture between Fletcher Construction Company Ltd, trading as Brian Perry Civil, and Keller Ground Engineering, a worldwide ground engineering specialist, to provide an estimate. This was done and Relevel presented a report on 21 September 2011. It recommended a process of relevelling whereby LMG would be used to lift and polystyrene foam to fill the void beneath the slab. The report stated: "[t]he overall success of the re-levelling exercise will depend on the soil condition and how the structure reacts to the relevelling loads." The cost of the work was estimated at $125,225 together with GST.

[92] Following receipt of the Relevel report, Stream sent a report to Tower on 20 October 2011 that set out a detailed scope of work for reinstating the damage using the LMG method to relevel the base. It estimated an overall repair cost of $341,625.74. Tower forwarded that report on to the O'Loughlins. Mrs O'Loughlin responded, saying that she did not consider the house to be repairable and raising a number of specific queries about the scope of the work.

[93] In response, Tower arranged a meeting at the O'Loughlins' house on 6 December 2011. There were further discussions, and Stream issued a revised scope of work on 7 February 2012. Mrs O'Loughlin sent an email on 8 February 2012 in which she said: "[i]t is our opinion that the foundation cannot be lifted successfully and should be replaced." However, on that day, the O'Loughlins signed

an acceptance of a proposed scope of works. It is not suggested that this document in any way bound the O'Loughlins as to what work was to be carried out. It is therefore not necessary to consider the evidence that was given about the alleged pressure that the O'Loughlins were placed under to sign this document.

[94] On 24 February 2012, Stream sent Tower a settlement report that included an estimate for repair work of $337,649.36.

[95] During February 2012, the O'Loughlins appointed WorldClaim NZ Ltd (WorldClaim), part of a worldwide global claims management company, to assist them in the claim. WorldClaim responded to Tower's report on 19 March 2012, advising that it had been appointed to "prepare and negotiate" the O'Loughlins' claim. Its agreement with the O'Loughlins provided that the O'Loughlins would pay a fee to WorldClaim of 25 per cent plus GST of all monies paid or payable by Tower above its estimated repair costs of $338,000. WorldClaim sought a copy of the policy document, which was provided. On 4 May 2012, WorldClaim emailed Tower to advise that it would supply a "scope of works" to Tower in the near future. It sought further information from Tower.

[96] On 21 May 2012, the O'Loughlins agreed to accept the second option offered by CERA and sell their land to the Crown for the 2007 rating value of $110,000. As part of the sale they had to assign any insured land claims to the Crown.

[97] WorldClaim then on behalf of the O'Loughlins sent a scope of works to Tower, claiming that it would cost $1,352,194.81 to rebuild the house. In the period that followed, WorldClaim strongly suggested on a number of occasions that Tower representatives meet with it to discuss the claim. Tower refused to meet, saying that it declined to review its scope of works and reiterated its offer based on a total repair cost of $337,649.36.

[98] On 16 October 2012, following a discussion between Mr Ashe and Mr O'Loughlin, Mr Ashe emailed Mr O'Loughlin reiterating Tower's offer. He stated that this was not being made in full and final settlement, so that the

O'Loughlins could continue to discuss with Tower the settlement to which they believed they were entitled.

[99] The O'Loughlins then issued these proceedings claiming, amongst other things, judgment for the replacement value of the property on the basis that to rebuild on the current site would cost $1,352,194.81, together with general damages of $50,000, on 31 October 2012. In due course both sides retained experts to justify their positions.

[100] The issue is whether Tower discharged its obligations to the O'Loughlins by its offers from 2012 onwards to pay them, and by making an actual payment during the trial, based on a repair using the LMG option for relevelling. The plaintiffs have retained an expert supportive of that option. The defendant's experts reject it. Tower's position from the outset has been that actual repair was not an option, but it would pay the costs of a notional repair. The O'Loughlins' position was and is that the actual repair proposed by Tower would not work, and a payment based on a rebuild, rather than repair, was required.

[101] The O'Loughlins sold the land in October 2012 to the Crown. Therefore, the option of actually doing the repairs is not available. The repair option is thus to be considered in the hypothetical.

[102] In terms of the repair methodologies at issue, an assessment is necessary as to whether Tower's repair methodology would be approved under the Building Act 2004 and the New Zealand Building Code (the Building Code).[75] If it does not comply with the Building Code, it will not get a consent. If it would not get a building consent, the repair proposed by Tower is not a practical option or a fair basis for the assessment of a payment to the O'Loughlins. If, on the other hand, Tower's repair methodology will get a consent and is an appropriate repair option, then Tower's offer was fair.

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[75] The New Zealand Building Code was originally created under the now-repealed Building Act 1991, and continues in force under s 415 of the Building Act 2004.

The engineers

[103] Mr Zoran Rakovic was the sole engineer called by the O'Loughlins. He is a qualified structural engineer working in Christchurch. He has been involved in inspecting and reporting on over 100 properties affected by the Christchurch earthquakes, and is the lead structural consultant on a major post-earthquake recovery exercise. He is not a geotechnical engineer.

[104] The defendant called a geotechnical engineer, Mr Nicholas Harwood, who is a principal engineer at Coffey Geotechnics. He is the technical leader of the geotechnical business of its Christchurch office. He is a well qualified geotechnical consultant, and has been involved on Tower's behalf in a large number of projects requiring expertise in geotechnical earthquake engineering in Christchurch since 4 September 2010. He has reported to Tower on hundreds of earthquake damaged sites in the Canterbury earthquake region.

[105] Tower called two structural engineers. The first was Mr Samuel Polson, an experienced senior structural engineer who has worked on a number of major international projects since joining Engineering Design Consultants Ltd in January 2012. He has been heavily involved in the assessment and repair of residential properties in Christchurch for Tower.

[106] The second structural engineer called by Tower is Mr Ashley Smith, a structural engineer living in Auckland and a principal of Structure Smith Ltd. He has had wide overseas and New Zealand experience as a project engineer, and as structural design leader on a large number of major projects. His experience includes investigations in Christchurch for various bodies.

[107] Mr Shand submitted that none of the three engineers called by Tower could be regarded as independent. I consider that Mr Smith, who is based in Auckland and has only done limited recent work for Tower, can be regarded as independent of the parties. So can Mr Rakovic. While it was perfectly proper for Messrs Harwood and Polson to give evidence, they are not in the same category given their close work connection with Tower.

Where the engineers agree

[108] The four experts all met and prepared a document called "Minutes of meeting dated Wednesday 27 February 2013", in which they recorded some matters on which they agreed and disagreed.

[109] The experts believe that the foundations of the O'Loughlins' house could be relevelled in a manner compliant with the Building Code, but do not agree on how that could be done. They record that there is in existence the Ministry of Building Innovation and Employment's (MBIE) guidance document (the guidance document).[76] This is "not a New Zealand Building Code compliance document", but when used appropriately together with engineering analysis and judgment, is as an alternative means of establishing compliance with the Building Code.

[110] The guidance document outlines three "technical categories": TC1, TC2 and TC3.[77] Land "on the flat" (in distinction from the areas affected by liquefaction in the Port Hills area[78]) was assigned into those three categories, based on the land's "expected future liquefaction performance".[79] The guidance document states:[80]

> **TC1:** Liquefaction damage is unlikely in future large earthquakes. Standard residential foundation assessment and construction is appropriate.
>
> **TC2:** Liquefaction damage is possible in future large earthquakes. Standard enhanced foundation repair and rebuild options in accordance with MBIE guidance are suitable to mitigate against this possibility.
>
> **TC3:** Liquefaction damage is possible in future large earthquakes. Individual engineering assessment is required to select the appropriate foundation repair or rebuild option.

[111] The experts agree that the land at the site has TC3-like ground performance properties. It was accepted by both the plaintiffs and defendant that if the land was not in the red zone it would be TC3 land.

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76 Ministry of Business, Innovation & Employment *Guidance: Repairing and rebuilding houses affected by the Canterbury earthquakes* (version 3, December 2012) [Guidance document].
77 At 1.4.
78 At 1.1.
79 At 1.4.
80 At 1.4.3.

[112] The minutes record that the house and internal garage have a partly reinforced concrete slab foundation. There is reinforcement in the garage area but not in the concrete under the house. The cladding is a mixture of lightweight rockcote cladding and heavy weight brick cladding. It is recorded that this is an MBIE type C2 dwelling for the purposes of the guidelines.[81] It is also recorded that the MBIE type C2 recovering methods could be applicable, when accompanied by an appropriate engineering assessment demonstrating compliance with the Building Code.[82]

[113] Because of the floor coverings, the full extent of the cracks in the concrete base could not be determined. The cracks were earthquake induced. Most of the strip foundations cannot be inspected because they were obscured by the concrete slab on the ground outside. Floor coverings would need to be lifted throughout the house to establish the full extent and nature of the cracks across the floor slab area.

[114] Strip foundations would have to be excavated and exposed to establish the full extent and nature of any cracks or other damage. It is noted that foundation relevelling is a possible recovery strategy, and this could include LMG and other techniques. It is recorded:

> It will take a concerted collaborative effort between the geotechnical engineer, the structural engineer and the specialist re-levelling contractor to develop the design to ensure the works are code complaint. This will involve judgment and assessment of issues such as (but not limited to) performance of the altered foundations under design loads (including earthquake loading that could trigger liquefaction), durability and slab damp-proofing.

[115] The engineers believe that the concrete base could be relevelled in a manner compliant with the Building Code and that the foundation and superstructure could be repaired and the works given consent. However, the actual means of doing this are left open, and it is stated that they "… would need to be derived via engineering analysis and judgment by competent chartered professional engineers (geotechnical and structural), and in consultation with an experienced specialist contractor."

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81 See discussion of these terms at 2.1 and in this judgment at [127].

82 See discussion of these terms at 14.6.

Where the engineers disagree

[116] Mr Rakovic did not rely on the guidance document in his original written statement, but referred to it in reply. He noted that the guidance document did not include buildings in the red zone, and therefore was not strictly applicable. He observed that in terms of the guidelines, the house contained heavy concrete masonry and a boundary wall, and did not fall within the relevelling option in the guidance document.

[117] In his view, relevelling was not automatically a viable option. In his reply brief he stated he was not satisfied that there was sufficient evidence from Tower's engineers to clearly demonstrate load paths, appropriate material strength, adequacy of ground bearing measures, and mitigation of ground deficiencies including liquefability and other matters. He considered that the LMG bulbs would concentrate ground pressures rather than spread the loading (although I note that he erroneously assumed that the bulbs would actually push against the existing foundation whereas they will in fact be at a lower point in the ground pushing up the soil). He was not satisfied that the existing foundation system and structures would sustain the proposed injection bulbs and emphasised the unreinforced nature of the ground floor. He was not satisfied that the unreinforced concrete slab would reliably span between the injection points. He stressed a number of other ways in which the Stream proposal was not demonstrated to comply with the Building Code in this particular situation.

[118] Mr Rakovic considered that Tower's proposed repair contravened the ethical obligation of an engineer to minimise the risk of death, injury and suffering. In his opinion, for the house to comply with the Building Code it would require some form of piling down to firm strata below ground surface. The most economical repair would be to remove the house from the site, demolish the existing foundations and slab, and construct new pile foundations and a new slab. This would involve, in essence, "a rebuild of the house from scratch". He maintained that he had the ability and skill to comment on geotechnical matters so far as they related to the soundness of the foundations for the house.

[119] Mr Harwood was on the other hand critical of Mr Rakovic's ability to comment on geotechnical engineering matters. It was his opinion as a geotechnical engineer that the site was better than a number of TC3 sites that he had assessed. He considered that the O'Loughlins' house satisfied the relevelling criteria in the guidance document, and any of the relevelling options including the LMG option could be adopted. He noted that the structure of the concrete base had not failed, but rather the ground below. He had only observed minor cracking. He noted that grout or resin injection methods have been used successfully for decades across the world, including in Christchurch, and are referred to in a variety of relevelling methods set out in the guidance document. The injection bulbs would provide lift under the heavier load bearing elements of the building, and resinous grout could be used to provide finer control for other areas.

[120] Mr Polson relied on Mr Harwood's geotechnical opinion. He referred to the variety of relevelling alternatives set out in the guidance document. He observed in his report: "[w]ith the repairs documented and attached to a producer statement PSI and certificate of design work, we see no reason why building consent for the repairs would not be granted."

[121] Mr Smith in his evidence also referred to Mr Harwood's report. He noted that the ground slab might not contain steel reinforcement apart from the garage area. Despite the fact that this meant it would not comply with the current Building Code as if it were a new house, it was only the building work that was being undertaken that must comply with the code. Further, the building as a whole did not need to comply with the code after the foundations had been repaired. He considered that there was very little likelihood that the base slab had ruptured, and it was his view that it was not likely to rupture if the foundation was relevelled as proposed using the LMG method. He considered that the property was at the lower end of the repairable damage range described in the guidance document, and it could be repaired using the LMG option.

[122] Mr Smith agreed that an application for building consent would need to demonstrate compliance with elements of the guidance document, and that the repairs "would need to be investigated, analysed and designed by engineers with

specific expertise in … geotechnical and structural engineering". He would have the skills to prepare such a document but had not been asked to provide it. If he were, preparing such a plan would involve one of the specialist relevelling contractors jointly developing a more detailed design and construction methodology as recommended by the guidance document. He considered that Tower's relevelling proposal would be "technically acceptable from a structural point of view" and there was no reason why it would not be successful. In his view, relevelling was feasible from a structural standpoint and he could see no reason why it would not be successful and durable.

Mr Hutt's evidence

[123] The plaintiffs by consent produced a witness statement of Anthony Hutt, a team leader of the Christchurch City Council Building Operations Unit, and a person able to give expert evidence on whether a building permit would be granted by the Council. Consistent with the minutes of the engineers meeting, he was of the view that the building work that would be required to remediate the base plate would require a building consent "as the work would involve the complete or substantial replacement of a component or assembly contributing to the building's structural behaviour." He observed that the guidance document was aimed at houses in the CERA designed green zone, with the expectation that houses in the red zone would generally be on ground that would perform worse than land assessed as being on TC3 land. The guidance document would be of use to the Council, in that the level of investigation, analysis and design required for a red zone property should be at least as much as that required for TC3 land.

[124] Mr Hutt observed that the documentation provided by Stream and Relevel did not provide the investigation analysis or design required, so it was not sufficiently comprehensive to demonstrate compliance with the Building Code. In particular, information to support an application for building consent would need to show that the work would comply with the structure and durability sections in the guidance document. The proposal he had reviewed did not include sufficient information to determine whether there was, or could be, code compliance.

The guidance document

[125] All of the engineers acknowledged the importance of the guidance document. It was issued under s 175 of the Building Act 2004. It is expressed to be only a guide, and if used does not relieve any person of the obligation to consider any matter according to the circumstances of the particular case.[83] Even though it is not technically a document where compliance was a requirement, the evidence that I have shows that it would be the most relevant guidance document that would be taken into account by the Council in considering a building consent application. It is a complex 283 page document. The first draft came out in December 2010 and the version before the Court was dated 12 December 2012, although it was issued in January 2013.

[126] As set out above,[84] the TC1, TC2, TC3 categories are described as anticipating how the land might perform in future large earthquakes and what foundations are appropriate to reduce the risk of injury and damage.[85] It is stated that the methods and solutions proposed in the document are not mandatory, and different and improved details and methods may well be developed as the recovery proceeds.[86]

[127] The LMG option is listed as a lifting option in the guidance document, for relevelling and repairing foundations and floors in TC1 and TC2.[87] The O'Loughlins' property came within the category of a TC3 type C house as it was on a concrete base. Such houses are distinct from those with a timber floor with piles, or houses with a timber floor with perimeter footing.

[128] Table 14.2 of the document was the subject of considerable attention during the cross-examination by Mr Shand of some of the defendant's experts.[88] The table showed an overview of the process for repairing foundations on TC3 sites for foundations of type C property. An issue in the cross-examination was whether the

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83 Guidance document, above n 76, at 2.
84 See above at [110].
85 At 4.
86 At 5.
87 At A1.
88 At 14.4.

O'Loughlins' house fell into scenario case two where relevelling was a stated option, or cases three and four where the options were either removing or raising the house to install a fully TC3 compliant solution (consistent with Mr Rakovic's opinion), or removing heavy roof and wall elements and replacing with lightweight elements and retrofitting ground improvement. The guidance document stated that the calculation of vertical consolidation settlement of the upper 10 metres of the soil profile under serviceability limit state (SLS) loadings had been chosen as the basis for the 100 millimetre number, and that this index value was a guide to what is to occur by way of options.[89]

[129] Where the settlement was less than 100 millimetres on the SLS measure of performance it would come under case two rather than cases three and four.[90] The calculations prepared by Mr Harwood indicated that on three measurements, the SLS settlements were on each occasion less than 100 millimetres. Mr Harwood's three measurements were 8.349 centimetres, 9.149 centimetres and 11.407 centimetres. Mr Shand put it to Mr Harwood that he was wrong in his calculations in that he had rounded the figures to a summary total below 100 millimetres.

[130] Despite Mr Shand's propositions, I do not accept that the end figure was manipulated by Mr Harwood. In fact, if the three figures are added together and divided by three, the average of each was 9.635 centimetres, just under the 100 millimetre level.

[131] The building performance also needs to be assessed in terms of the influence of heavy roofing or cladding materials on settlement. If the performance has been poor "then it is strongly recommended that any heavy roofing materials and heavy cladding materials are removed and replaced with lightweight materials before relevelling." It is to be observed it was proposed by Relevel and incorporated in the quantity surveyors costings that the brick cladding for this house be removed.

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89 At 12.6.

90 See Table 14.2.

My assessment of the LMG proposed repair

[132] It is made clear in the guidance document that assessments such as the SLS assessment are not necessarily definitive, and in each case there will be an exercise of judgment in deciding the appropriate method of relevelling.[91] It is stated that understanding the performance requirements for SLS and TC3 will present a challenge for engineers, and "there will be considerable variability and uncertainty for engineers in attempting to quantify further building settlement performance for TC3 properties."[92]

[133] That variability and uncertainty is very evident in the material I have reviewed. It a feature of the history leading up to the proposed repair. The proposals of Stream and Relevel were expressed in conditional language. Relevel's quote is unsurprisingly not fixed or immutable. This property would have been in the most vulnerable TC3 category if it was not in the red zone. While it is likely to have not quite reached the 100 millimetre case three or four category on the SLS test, which would have required removal and raising or significant ground improvements, it was on the cusp of being in that category, having an average of 96 millimetres on the SLS scale.

[134] As stated above, it was Mr Harwood's view that despite the O'Loughlins' land being in the red zone, its geotechnical properties were much better than a number of TC3 sites he had assessed. He noted that there was nothing new in relevelling by using grout or resin injection methods. Mr Galbraith's submissions emphasised that it was the specific evidence of Messrs Harwood, Polson and Smith that under section 4 of the guidelines, LMG would, in their view, be adequate. He also emphasised that in Appendix A1 to the guidelines, various options using LMG together with jacking are set out together with an option using LMG only.

[135] However, section 4 of the guidelines focuses on local repairs and relevelling for TC1 and TC2 properties and Appendix A relates to repairing foundations and floors in TC1 and TC2 properties. Despite Mr Harwood's reservations, Tower

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91 At 14.2.
92 At C.1.1.

accepted that this was a TC3 property. In my assessment, that concession was properly made. Given that it is in the most affected red zone area, and given the obvious serious effects of liquefaction on the site and Mr Rakovic's views, I do not accept that the Council will treat any building consent on the basis that the guidelines applying to TC1 and TC2 areas apply to this site. It is possible that they might be persuaded to do so, but not on the information presently available.

[136] Mr Hutt's unchallenged evidence does not provide any assurance at all that the Council would in fact grant a building permit for a LMG option on the site. Given his statements that red zone land would be regarded as generally being ground that may perform worse than land assessed as TC3 land, it can be anticipated that the Council's scrutiny of an application would be intense. It would be mindful of the statements in the Cabinet papers leading to the creation of the red zone, namely of the high risk of further damage to land and buildings from aftershocks and flooding, and that land repair solutions will be difficult to implement.

[137] The Building Code now requires that a concrete floor slab have reinforced steel in it. This does not mean that the building permit would fail, as s 112(1)(b) of the Building Act 2004 provides that the building consent authority need only be satisfied that the building continue to comply with the other provisions of the Building Code to at least the same extent as before the alteration. However, the fact that the concrete floor slab does not have reinforcing steel in it, and the repair postulates it being lifted using the LMG method, is undoubtedly a factor in assessing risk contingencies.

[138] Mr Rakovic did seem to me to have a rather rigidly conservative view as to the appropriate repair, in that I found his conclusions on the need for absolute safety to be extreme. He had no experience in using LMG and he had not attended Ministry workshops. However, his concerns about the use of this untested method of relevelling, in an area where the ground had been so damaged and which is so vulnerable in the event of further earthquake activity, seemed to me to have real merit and be consistent with the guidance document. I am far from convinced on the material before me that Mr Polson was right in his assertion that with the appropriate

documentation a building consent would be forthcoming. The devil will be in the detail. That detailed work has not been done by Tower.

[139] Mr Hutt for the Council specifically observed that the documentation provided by Stream and Relevel is not sufficiently comprehensive to demonstrate compliance with the Building Code. The defendant's three engineers and Mr O'Leary have not themselves been involved in a relevelling exercise using solely LMG on a house site, but they now propose that this be the basis of a repair on the O'Loughlins' site. Nor has Mr O'Leary of Stream. Thus, none of them were able to speak in favour of the proposed repair from direct experience. I note that Stream in its original report referred to the LMG option as a "hypothetical repair option", and in its report of 21 September 2011 noted that the overall success of the relevelling exercise would depend on soil condition and how the structure reacted to relevelling loads.

[140] On the face of it, Mr Rakovic is right when he says that there is a risk of failure of the slab in a relevelling exercise. Mr Polson accepted that this was a risk which would have to be very carefully controlled by the contractor. I note also the qualified nature of some of the defendant's engineering evidence. Mr Polson stated that before a building consent could be obtained, there was a succession of requirements, including: the need to prepare a method statement; to collaborate with geotechnical engineers, a relevelling contractor and possibly an architect or architectural designer; the necessity to produce calculations, sketches and drawings; and the requirement to provide a producer statement and a certificate of design work.

[141] Mr Smith did not, in his evidence, say whether if this material was available building consent would be granted. His comment was that he had not been asked to provide documentation to support a building consent application, and if he was asked to do so he would work with a relevelling contractor such as Relevel in the design process to "jointly develop a more detailed design and construction methodology as recommended in the MBIE guidance."

[142] The defendant's engineers may be right and relevelling might be accepted by the Council, but so also might Mr Rakovic be right. The Council could take the view

that this, being a TC3 qualifying property in the red zone with a base slab which is unreinforced and has cracks, should be treated as being in case three or four under the guidelines. It might require a fully TC3 compliant solution with new pile foundations.

[143] The calculations of the two quantity surveyors Messrs Eggleton and Harrison, who agree on $390,000 as the cost of the proposed LMG option, include a significant contingency allowance. However, neither of them have been in any way engaged in what costs would be involved if the Council was not satisfied with the documents as provided and required further work not allowed for. They have not allowed for a major problem arising if the relevelling process did not initially work, such as the concrete base developing major structural cracks.

[144] So in the end, I am not satisfied that the proposed building consent would be forthcoming for a LMG repair, or, even if it was, that there might not be unforeseen problems and extra work to be done which would lead to the estimate of repairs being considerably exceeded. I do not think it reasonable for Tower to provide a cheque on the basis of a cost of a repair that is untested, and comes with apparent risks of failure or complications that could lead to significant cost overruns.

Questions of onus

[145] Given that this is my conclusion, it is necessary to consider where this leaves the parties in terms of the contract and whether Tower's proposal to pay the estimated repair costs of $390,000 complies with its contractual obligations. Both parties made submissions on the onus of proof. Mr Shand submitted that the onus was on Tower to show that it was certain the LMG option was the appropriate repair option and $390,000 was the fair figure for that. Mr Galbraith was cautious as to where the onus lay, but submitted that at the highest the issue was whether, on the balance of probabilities, the proposed LMG option would obtain a building permit and be able to be completed as anticipated by Tower's engineers. In his reply submissions he observed that the question is whether the Court is satisfied that the payment of $390,000 was reasonable.

[146] The general principles as to onus of proof are clear. The onus is on the insured to prove the existence of the contract, and show that the event in question was covered by the policy and claimable loss has been suffered.[93] On the other hand, an insurer has to prove that a claim to which the risk insured against otherwise applies, falls with an exception or exclusion.[94]

[147] The O'Loughlins, as the insured, have brought this claim and have the insured's onus of proving loss. If they had sought to do the repair themselves they would have had the onus of proving the reasonable cost of those repairs if they claimed them from Tower. But this contract provides that it is Tower's option as to how it provides replacement value.[95]

[148] The difficulty in assessing the correct approach is that neither party has done an actual repair. Tower has chosen to make a payment based on a hypothetical repair. Neither party has presented any authority on how to approach the question of onus in such a situation, and my research has not revealed any.

[149] If Tower had elected to do the repair itself, the policy would have been treated as a repair contract and the insurer would have been responsible for the quality of the work carried out.[96] If the work was defective the insured could sue the insurer for damages to remedy that defect.[97] The obligation would thus have been on Tower to complete the repairs even if the cost turned out to be much greater than replacement value.[98] The O'Loughlins could have sat back and let Tower do the work with any problems and cost overruns being Tower's responsibility.

[150] Given the burden that would be on Tower to complete replacement repairs if it had actually undertaken the repair, it follows that the same burden is on Tower where it elects to make a payment based on an equivalent notional repair rather than actual repair. Its offer was based entirely on the advice of its contractor Stream, based on the Relevel quote, and the O'Loughlins had no input or say. I recognise

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93 *Kelly and Ball*, above n 57, at [8.0190.1] and [8.0190.5]; Anthony Tarr and Julie-Anne Kennedy *Insurance Law in New Zealand* (2nd ed, The Law Book Company Ltd, Sydney, 1992) at 174.

94 *Trickett v Queensland Insurance Co Ltd* [1936] NZLR 116 (PC) at 119.

95 See above at [37]–[39].

96 *Insurance Law Doctrines and Principles*, above n 72, at 345.

97 *Robson v New Zealand Insurance Co Ltd* [1931] NZLR 35 (SC).

98 *Robson*, above n 97*; Times Fire Assurance Co v Hawke* (1858) 175 ER 783, 1 F & F 406 at 407.

that it is difficult to assess the performance of a hypothetical. But Tower has assumed that burden in choosing this notional payment calculation to meet its replacement obligation, and based the payment on its own contractor's estimate of a notional future repair. In my view, Tower has by its actions assumed the burden, with the standard being on the balance of probabilities. It has, for the reasons I set out below, failed on the evidence adduced to establish that the LMG repair could be carried out for $390,000.

[151] In case I am wrong in this, I alternatively approach the question of onus in terms of there being the onus on the O'Loughlins to prove contractual breach, including the inadequacy of the offered payment based on an LMG repair.

[152] Tower is contractually obliged to provide the O'Loughlins with "full replacement value".[99] That is the sum that represents the hypothetical costs that would, under the definition of that term, "actually" be incurred if the repair was done to put the property into "… the same condition and extent as when new". The O'Loughlins do not have to prove that Tower, having chosen the LMG hypothetical repair payment, could never get a building consent to an LMG repair, or that there would be large cost overruns. That would be to make them disprove a hypothetical chosen by Tower. But assuming the onus is on them, they have to prove on the balance of probabilities that on the information before the Court, Tower is in breach of its contractual obligation to pay full replacement value in terms of the policy. That has to be assessed objectively on the basis of what is reasonable, given the obligation to provide full replacement.

[153] Mr Shand referred to decisions of the Court of Appeal of Louisiana, *Occhipinti v Boston Insurance Co*,[100] and *Higginbotham v New Hampshire Indemnity Co*,[101] where it was held that a payment in lieu of repairs had to be on the basis that there was no possibility, even remote, of the hypothetical repairs being inadequate. At its strongest, his submission was that Tower had to show that the repair was guaranteed to succeed. For the reasons already given,[102] because of the

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99 See above at [38].
100 *Occhipinti v Boston Insurance Co* 72 So 2d 326 (LA 1954).
101 *Higginbotham v New Hampshire Indemnity Co* 498 So 2d 1149 (LA 1986).
102 See above at [49].

differences in the law applied in United States jurisdictions, I do not rely on those cases, or see the onus in those terms.

Is the offer of $390,000 calculated in compliance with Tower's contractual obligations?

[154] For the reasons that I have set out, I have reached the view that on the evidence before me the LMG repair is too uncertain and a payment based on it cannot be regarded as representing the actual costs of repair. In my view, on the information available, no reasonable insured or insurer would commit to carry out actual repairs in this way. The O'Loughlins have shown that Tower is in breach by attempting to fulfil their obligations under the contract through provision of a payment that does not meet the contractual standard of full replacement value.

[155] To put it another way, a reasonable home owner would not embark on the LMG repair if that home owner could not afford more than the $390,000 Tower is offering. This is because, as I have set out, there would be a real prospect of the repair not getting consent, or there arising major problems with the unreinforced concrete base, and the repair costing more than the sum allowed. The repair option carries such a significant degree of risk that it is unacceptable.

[156] It was open to Tower to present a notional repair scenario and calculation far more certain than that offered to this Court. Tower could have obtained the investigation analysis or design referred to by Mr Hutt that was sufficiently comprehensive to demonstrate compliance with the Building Code. It has not provided the "sufficient information" referred to by him. Mr Polson was not asked to provide the repair documentation, or produce a statement and certificate of design work which he referred to as requirements for a building consent. Indeed, it would have been open to Tower to have sought a building consent to show that its proposed repair would comply. It would have also been open to Tower to carry out a mobile grout relevelling exercise at its own risk to show that the technique would work on a concrete base such as that of the O'Loughlins. It did not take these steps. On the evidence I am left quite uncertain whether the $390,000 would be adequate, and do not consider that it equates to the "actual" costs of replacement.

[157] It may be that if further steps were taken of the type referred to, a Court could be satisfied that the LMG option for such a site would get or has got a building consent and other concerns are allayed. I emphasise that my decision is specific to this case and the evidence presented.

[158] I conclude that Tower has failed to establish on the balance of probabilities that the LMG repair could be carried out for $390,000. To put it alternatively, the O'Loughlins have established on the balance of probabilities that the Tower offer based on a payment of $390,000 less the EQC payments does not meet Tower's obligation to pay for the replacement value of the house on the basis of the estimated costs of repair. I do not consider that the proposed LMG repair is an "actual" repair in terms of the replacement value promise that would be reasonably carried out on this site. I conclude that on the evidence before me, and on the basis of the terms of the policy, a payment calculated on the basis of the estimated costs of rebuilding with pile foundations, or the cost of a replacement house, was required. The offer of $390,000 was not therefore calculated in compliance with Tower's contractual obligations.

What then is Tower's obligation?

[159] Assuming that Tower was not fulfilling its contractual obligations in offering a payment based on a notional LMG repair, Mr Shand argued that Tower was obligated to pay for the cost of rebuilding on the present site, which was the sum agreed by the quantity surveyors of $620,000. Alternatively, if he was unable to obtain a declaration for a payment up to that sum, he invited the Court to direct that the rebuild costs on a good site of $540,000 be paid. In both instances it was accepted that EQC payments must be deducted.

[160] Mr Galbraith, on the other hand, submitted that should the repair payment option be found to be not in accord with Tower's contractual obligations, then it was up to Tower as to which of the other options set out in the insurance policy it would exercise.

[161] The section under the heading "How we will settle your claim" has been set out above,[103] along with the definition of full replacement value.[104] The policy also states that in all cases:[105]

> - **we** have the option whether to make payment, rebuild or replace or repair **your house.**

[162] It is usual for a reinstatement clause to provide the option of a payment, as an alternative to the restoration to the assured of the property damaged or destroyed.[106] Which party has the option of choosing a payment rather than restoration turns on what the contract says.

[163] As set out above, it is stated specifically in this policy under the general heading that "[i]n all cases" Tower has the option whether to make payment, rebuild, replace or repair the house. This sentence is quite unambiguous and explicit. It is the insurer and not the insured who has the option.

[164] Consistent with this, it is stated earlier in the policy that Tower "will only allow" rebuilding on another site or the buying of a house if the insured's house is damaged beyond economic repair.[107] It is stated that Tower will not pay the costs of rebuilding, replacing or repairing any part of the insured's house which at the time it was built was otherwise in accordance with a building permit or other applicable consent issued by the relevant authority.[108]

[165] On the other hand, it is stated under the heading "How we will settle your claim", under the subheading "We are not bound to":[109]

> - pay more than the **present day value** if **you** have **full replacement value** until the cost of replacement or repair is actually incurred. If **you** choose not to rebuild or repair **your house** or buy another house **we** will only pay the **present day value** and the reasonable costs of demolition and removal of debris including contents;

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103 See above at [37].
104 See above at [38].
105 Policy, above n 25, at 11.
106 John Birds, Ben Lynch and Simon Milnes *MacGillivray on Insurance Law* (12th ed, Sweet & Maxwell, London, 2012) at [22-002].
107 Policy, above n 25, at 11.
108 At 11–12.
109 At 12.

[166] The reference there is to the insured choosing an option. This option is indemnity on present day value, which is not one of the stated Tower options. The O'Loughlins have not sought to exercise the indemnity or "present day" option, which would bind them to market value less section value. The fact that the insured has an option to seek present day value does not diminish Tower's power to choose between the replacement options. It would only do so if the O'Loughlins had sought to invoke the present day value option. They have not. They want replacement.

[167] The explicit wording giving options to Tower can be contrasted to the insurance policy discussed in the recent High Court decision of *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd*, also in the context of an insurance claim after the Christchurch earthquakes.[110] There the policy stated explicitly that the insured, not the insurer, could choose from the options of rebuilding on the same site or another site, or buying another house or receiving a cash payment. It all turns on the words of the policy.

[168] Tower has the choice, therefore, of whether to make a payment, or rebuild, replace or repair. It follows that Tower, in making the payment, can choose the basis of payment. That basis must be on a repair, rebuild or replacement basis, and if repair is not an option, which I have found it is not, Tower can choose between rebuild and replacement.

[169] Mr Shand argued that Tower had elected to pay the rebuilding costs. He relied on the statement in *MacGillivray on Insurance Law* that once an insurer has elected to pay or reinstate that insurer is bound by the election and cannot thereafter change its mind.[111]

[170] Tower has here elected to pay rather than carry out a repair, replace or rebuild. It offered a payment only from the outset. It cannot resile from that. However, it is not seeking to do so. It still wishes to make a payment, and is not proposing actual repair or rebuilding.

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110 *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd* [2012] NZHC 3344.
111 *MacGillivray*, above n 106, at [22-004].

[171] The real issue is not whether Tower has bound itself to make a payment, but rather whether it has elected to make that payment based on a particular type of notional reinstatement exercise. Once the repair option is put to one side, it cannot be said that there has been any choice or election made by Tower in relation to the other options that remain open to it, of paying the cost of rebuilding on site, rebuilding at a new site, or replacement at another site. Tower has not elected any one of these options at this point. It has certainly not opted for a rebuild option as distinct from any others. Indeed, it has resisted in all its negotiations with the O'Loughlins and in these proceedings any type of payment based on anything other than repair.

[172] In my view, the plain words of the "we will pay" section must apply and it is now up to Tower as to which of the remaining options, other than repair, it chooses. I therefore accept Mr Galbraith's submission that it is not appropriate that I make any declaration binding Tower to any particular option.

$620,000 or $540,000?

[173] The O'Loughlins seek payment based on a rebuild on the existing site, defective as it is having suffered major upheaval and liquefaction. The cost is agreed at $620,000. They argue that this is their entitlement under the policy, although the cost of rebuilding on a sound site out of the red zone is only $540,000. Mr Shand submits that even if there is a windfall in this, that is their entitlement.

[174] The insurance policy says:

> **We are not bound to:**
>
> …
>
> - pay more than the **present day value** if **you** have **full replacement value** until the cost of replacement or repair is actually incurred. If **you** choose not to rebuild or repair **your house** or buy another house **we** will only pay the **present day value** and the reasonable costs of demolition and removal of debris including contents;
>
> - *pay the cost of replacement or repair* beyond what is *reasonable*, practical or *comparable with the original*;

- repair or reinstate **your house** exactly to its previous condition.

(emphasis added.)

[175] Mr Shand also relies on the definition of full replacement value, as set out above.[112] This is the definition that expressly relates to a payment of full replacement value, as distinct from "present day" (indemnity) "value". Mr Shand placed emphasis on the words "condition" and "extent". He also emphasised "to the same condition and extent as when new", referring to the dictionary definition of condition and extent. He asserted that the house must be put back to exactly the same position and dimensions as before. He also argued that the phrase "as when new" was stronger than the phrase "as new".

[176] In *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd*, Dobson J noted the distinction between the obligation to reinstate or repair to a condition "as new" as against "when new".[113] He accepted a submission that "when new" involved a narrower base for comparison between the insured item and its replacement than "as new", which conveyed a sense of comparison between old and new, rather than direct replacement.[114] He held in that case that the connotation of "as new" was of the equivalent to the old, rather than a replication of the original.[115] He held also that the insurer's obligation was to meet the cost of constructing a new house of the same style and quality of materials as the property insured.[116] This was subject to the requirement for reasonable consideration of substitute materials or methods of construction where that would not affect the quality or character of the replacement structure.

[177] The full replacement value definition clause must be read in combination with the express provisions stating that Tower is not required to pay the cost of replacement or repair beyond what is reasonable, practical or comparable with the original, and is not required to repair or reinstate the house exactly to its previous condition. To my mind the meaning is plain. The obligation is to replace with a property of the same general physical condition and size as the O'Loughlins' pre-

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112 See above at [38].
113 *Turvey*, above n 110, at [17].
114 At [17].
115 At [24].
116 At [39].

earthquake home was, when new. It does not have to be an exact replica in terms of its physical position on the site or dimensions. It has to be comparable to the original house as when new. So a house that was not of good condition or was materially smaller in size or did not offer comparable amenities, would not qualify.

[178] What Mr Shand is seeking is a payment on the basis of a rebuild on the existing red zone house, which would give the O'Loughlins a windfall. The notional rebuild costs would be $80,000 more than the actual rebuild cost that the O'Loughlins would incur on a sound non-red zone site.

[179] Mr Shand emphasised in his submissions the fact that the house had sunk 620 millimetres and perhaps more, and it had also moved laterally from its pre-earthquake position. As I understand it, he went so far as to suggest that the obligation was on Tower to rebuild in the same exact position and height as the house before the earthquakes (although no evidence was adduced as to the cost of this). On this basis, if Tower had elected to actually repair or rebuild on the existing site, the whole house would have had to be lifted up to over half a meter for no good reason. This would involve unnecessary work that would not make the house in any way more habitable but greatly add to the cost. It would not be a practical option, and not in accord with the terms of the contract. For the same reason, a payment calculated on that same basis would not be in accord with the contract.

[180] Further, the absurdity is demonstrated by the alternative scenario of Tower having to pay for an identical replacement property. Mr Shand's interpretation would require Tower to replace with a house which in every respect replicated the O'Loughlins' home at Gayhurst Road. That would be an impossibility. It can be stated with certainty that no exact replica could ever be found. The contract can be construed to avoid an absurd result.[117]

[181] I conclude therefore that Tower's obligation is to make a payment based on a rebuild or replacement for a comparable house to the O'Loughlins' house to the same condition and extent as when new on a sound site in Christchurch. The

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[117] *Vector*, above n 22, at [8] and [138].

replacement house would have to be of comparable size and condition as when new, and offer the same amenities.

[182] The notional rebuild costs have been calculated on such a notional good site. The figure is $540,000. I do not accept therefore the rebuild figure of $620,000. I am not able to determine what the cost of a replacement house comparable on this basis to that of the O'Loughlins would be, as that would be a matter of up to the minute expert valuation opinion. Such a figure could not be determined unless particular comparable houses that were on the market were located. Their value, putting to one side the value of the land, would have to be calculated. There would be a question of whether any proposed replacement house was comparable, and met the full replacement value definition of "to the same condition and extent as when new".

The extent of the drop suffered by the O'Loughlins' home

[183] Although on the basis of my interpretation of the policy it is not necessary to resolve the dispute, I record that there was a difference between the surveyors called by the parties as to the extent to which the O'Loughlins' house has dropped as a consequence of the earthquakes. The O'Loughlins' expert, Mr Adrian Cowie, calculated the drop at about 620 millimetres. Tower's expert, Mr Lester Ironside, estimated the drop as in the order of 300–350 millimetres.

[184] I prefer Mr Cowie's estimate of the drop. He used as a reference a nearby manhole invert which had dropped 470 millimetres. Mr Ironside accepted that the manhole appeared to have dropped to that extent, and Mr Cowie's calculations were accurate. Mr Ironside had doubts about the accuracy of using the manhole invert as a reference. He did not consider it to be a reliable survey mark, and referred to a City Council warning. However, Mr Ironside conceded that the manhole was a useful measure. He accepted that there had been a significant drop and his own estimate was conservative. He agreed under cross-examination that the drop could be 600 millimetres.

[185] In the end, I found Mr Ironside's view that the drop was 300–350 (increased from his original estimate of 230 millimetres) to be hedged and not compelling. He effectively conceded under cross-examination that Mr Cowie could well be right. Mr Cowie's evidence was careful and measured. He weighed the validity of using the manhole as a reference, and his reasons for doing so made sense. I accept Mr Cowie's estimate of the extent of the drop.

General damages

[186] The O'Loughlins seek general damages. General damages will only be payable if there has been a breach of contract by Tower.

[187] There will be a breach of contract by Tower if it offers a sum of money that is less than its contractual obligations. My finding is that Tower made an offer calculated on the erroneous basis of a notional LMG repair, when such a repair was not in fact an available option, and it should have offered a payment based on rebuild or replacement.

[188] However, that does not necessarily mean that Tower was in breach of contract when it made its original offer and payment based on repair costs of $341,625.74, or when it made its offer and payment based on the increased repair figure of $390,000. This is because it may yet be shown that the payment offered, albeit on the basis of the erroneous choice of repair, was nevertheless sufficient to fulfil Tower's contractual obligations.

[189] Thus, the net amount originally offered by Tower after the deduction of the EQC payments was $137,739. That was less than should have been paid on a rebuild basis, if the EQC payments were deducted. That may have been less also, than the net value of a replacement house. But Tower may argue that it was more. If that were so, Tower may not have been in breach of contract in making the offer that it did.

[190] I have not had submissions on this issue, and I have not had submissions on whether it would be fair to the O'Loughlins to take into account a notional

replacement house value, when Tower had not made an offer on that basis. Indeed, I have not had evidence on what the value of a replacement house would have been at the time Tower made its offers.

[191] I do not therefore feel able to determine the issue of general damages at this point, as it is not clear in offering the payment it did, whether Tower breached its contract. Before I can do so, I will need further submissions. I will not therefore determine the issue of general damages in this decision which, for reasons I set out below, is an interim decision.

[192] I do note, however, that my findings are consistent with the position of Mrs O'Loughlin when she initially rejected the relevelling option and Tower's cheque calculated on that basis. Her position was, in my view, reasonable and correct. However, after WorldClaim's involvement the O'Loughlins initially sought a payment based on notional repairs of $1,352,194.81. This sum was far in excess of the O'Loughlins' contractual entitlement, and indeed at the start of the trial was substantially reduced, and then during the trial reduced further.

[193] Further, there was a conceptual error by the O'Loughlins in the approach taken in the proceedings, in that what was sought was the cost to rebuild the house on the existing red zone site which they have sold. I have found that the O'Loughlins were not entitled to such a payment, which would have involved a windfall.

[194] So the net result of my decision is that both sides in their pleadings approached their contractual obligations erroneously.

[195] There are therefore issues that will have to be addressed before the general damages can be determined. The effect of Tower offering to pay and the O'Loughlins not accepting payment may also be relevant.

Relief

[196] The statement of claim seeks a declaration that Tower is liable to pay to the O'Loughlins the full replacement value of the house, being the costs to rebuild the house to the same condition and extent as when new plus any decks, undeveloped basements, carports and detached domestic outbuildings. They also seek architects', engineers' and surveyors' fees in respect of the rebuild as well as costs of demolition and removal. They seek a declaration that they are entitled to up to a maximum of $416,113.50, as these costs would be incurred by them on building a house. In addition, they seek general damages of $50,000, interest and costs. Alternatively, they seek judgment for $416,113.50, general damages of $50,000, and interest and costs.

[197] The $416,113.50 is based on rebuild costs of $620,000 less the EQC payment. Given my finding that Tower has not elected to pay the rebuild costs, and my finding that in any event the rebuild costs would be for a rebuild on good land costing $540,000, no judgment can be given for $416,113.50, and that is not an appropriate maximum figure to put in any declaration.

[198] Given my finding that it is up to Tower to elect whether to pay on the basis of a rebuild or replacement house, it is not appropriate to place any figure as a maximum. The issue of importance will be what Tower elects to do. If it does elect to pay on the basis of a rebuild, then the maximum figure would be $540,000 less EQC payments of $203,886.50 and less the amount paid by Tower of $197,179.15, being a net of $138,934.35. If it elects to replace, the value may be different. In any event, it is doubtful whether the insertion of any maximum figure would be of any assistance to the parties.

[199] It is not possible at this point to be prescriptive as to how, if Tower wishes to elect the replacement option, the parties should go about that process of calculating the correct figure. Normally if it was an actual replacement there would be a co-operative situation with a comparable replacement property in terms of the policy being found and agreed. In the event of a payment in lieu of actual replacement, the process is less easy to define without the issue being argued. In the end, if that path

is pursued and there is an impasse, the parties could seek a declaration or judgment for a specific sum.

[200] But given my findings, I cannot at this stage grant the declaration sought in the words set out in the prayer for relief, even with a figure calculated on a $540,000 rebuild. That would take away from Tower the right to elect and require Tower to pay the full replacement value of the house being the cost to rebuild it.

Result

[201] I decline to enter judgment for either the plaintiffs or defendant on the basis of the relief presently sought.

[202] Given my findings, I would be able to make the following declarations which I express tentatively given that I have had no submissions on the terms of such orders:

(a) The creation of the red zone did not constitute or cause physical loss or damage or natural disaster damage to the O'Loughlins' house.

(b) The cost of repair calculation, which was the basis of Tower's offer and its payment, was not in accordance with Tower's obligations under the policy.

(c) Tower is bound to make a payment for the full replacement value of the O'Loughlins' house on another site, calculated at its option on a rebuild or replacement basis.

(d) If the basis of calculation is a rebuild, the costings should be on the basis of a rebuild on another site, and not a rebuild on the existing site.

[203] Given that this is not the relief specifically sought by either party and the need for further submissions on general damages and relief, this will therefore be an interim judgment. The parties are asked to provide further submissions as to general

damages and the appropriate relief, given my findings. The plaintiffs are to file submissions within 21 days and the defendant within a further 14 days, with the plaintiffs having a right of reply within a further seven days. If the parties wish to vary these timetable directions they should file memoranda.

Costs

[204] I reserve the question of costs, and I direct the parties to file submissions on this question on the same timetable as the submissions to be made in relation to general damages and relief.

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Asher J