IN THE SUPREME COURT OF NEW ZEALAND

SC 141/2013
[2014] NZSC 147

BETWEEN	FIRM PI 1 LIMITED Appellant
AND	ZURICH AUSTRALIAN INSURANCE LIMITED T/A ZURICH NEW ZEALAND First Respondent
	BODY CORPORATE 398983 Second Respondent

Hearing:	3 July 2014
Court:	Elias CJ, McGrath, William Young, Glazebrook and Arnold JJ
Counsel:	M G Ring QC and C R Langstone for Appellant D J Goddard QC and W A Holden for First Respondent R G S Hay for Second Respondent
Judgment:	15 October 2014

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant must pay the first respondent costs of $25,000 plus reasonable disbursements. We certify for two counsel.

REASONS

ELIAS CJ and WILLIAM YOUNG J

(Given by Elias CJ)

[1] The appeal arises out of the determination of a question stated by agreement of the parties on which the High Court[1] and Court of Appeal[2] have reached different conclusions. The question stated was whether insurance for the replacement value of an apartment complex to a limit of $12.95 million was inclusive or exclusive of statutory insurance under the Earthquake Commission Act 1993. The apartment complex was badly damaged in the Christchurch earthquake of February 2011. The insurer, Zurich Australian Insurance Ltd, argued, unsuccessfully in the High Court but successfully in the Court of Appeal, that the sum for which it may be responsible (should the alternative claim of Body Corporate 398983, which owned the complex, that the replacement value cover limit had been lifted to $100 million fail at trial) is limited to $6.1 million, being the difference between the cover limit of $12.95 million and the $6.8 million paid to the Body Corporate by the Earthquake Commission under the statutory insurance scheme. On appeal to this Court, the firm of brokers which arranged the insurance on behalf of the Body Corporate contends that Zurich is liable to a limit of $12.95 million. The dispute arises because the replacement valuation on which the cover and its limit was based is well short of the $25 million now expected for replacement of the buildings.

[2] The appeal turns on the effect of the contract of insurance, objectively assessed in the context of the statutory insurance provisions of the Earthquake Commission Act. The Court of Appeal was of the view that the High Court had approached the question of interpretation on the correct basis.[3] It simply took a different view of the effect of the provisions. On further appeal to this Court, we consider that the general approach to construction taken in the Court of Appeal and in the High Court provides no occasion to traverse again the authorities since *Prenn v Simmonds*.[4] No novel point of general principle arises. In those circumstances we wish to reserve our positions upon matters of some controversy in this area of law,

---

1 *Body Corporate 398983 v Zurich Australian Insurance Ltd* [2013] NZHC 1109.

2 *Zurich Australian Insurance Ltd v Body Corporate 398983* [2013] NZCA 560, [2014] 3 NZLR 289 (Ellen France, White and Miller JJ).

3 At [35].

4 *Prenn v Simmonds* [1971] 1 WLR 1381 (HL).

which do not arise here but which are touched on in the reasons delivered by Arnold J, which we have had the advantage of reading in draft. Although we do not think discussion of general principles of contractual interpretation is called for here, that is not to say that we have found their application in the present case to be easy. In the end, we have come to a different conclusion from the majority in this Court. We would allow the appeal.

The contract of insurance

[3] The contract of insurance in issue was concluded in July 2009 by the Body Corporate through its brokers, ACM.[5] The contract, confirmed by ACM in a letter to Zurich, adopted the terms of the "Brokernet" policy (used by ACM) and attached a "Brokernet Policy Certificate". The Brokernet Policy Certificate was defined to be part of the policy and to constitute, with the policy, "one contract". The Brokernet policy was a generic document. The Brokernet Policy Certificate identified the particular parties, the property and sum insured, the period of insurance, and excesses. The policy covered "all Loss or Damage to the Property Insured during the Period of Cover due to an Event". The documents treat the cover for natural disaster damage as an "extension" to cover. That is terminology familiar in policies which do not cover natural disaster except by extension. In connection with natural disaster cover, the policy and the Policy Certificate refer to and cannot be sensibly understood except in the light of the Earthquake Commission Act and the cover it provides for natural disaster damage. "Natural Disaster Damage" is given in the policy the meaning defined in the Act and the cover provided is expressed to be limited to loss which exceeds that covered by the Act.

[4] So, cl MD15 of the policy provides what is to happen when the insurance relates to residential property covered by the compulsory cover under the Earthquake Commission Act:

> **MD15 NATURAL DISASTER DAMAGE**
>
> In the event of the Insured having insured residential property for which compulsory Natural Disaster Damage cover under the Earthquake Commission Act 1993 applies then in the event of such property suffering

[5] Now known as Firm PI 1 Ltd, but which has been referred to throughout the litigation under its former name.

> Natural Disaster Damage during the Period of Cover and covered by Natural Disaster Damage cover, then the Insurer[']s liability will be limited to the amount of loss in excess of the Natural Disaster Damage cover.

[5] The purpose of cl MD15 cannot be understood without reference to s 30 of the Earthquake Commission Act, itself enacted against the scheme of compulsory insurance provided by the Act in ss 18 to 22. By s 18, residential buildings insured for fire are deemed to be insured under the Act against natural disaster damage (including earthquake damage). The statutory insurance is for replacement value limited to whichever is the least of the amount of fire insurance taken or the amount arrived at by multiplying the number of dwellings in a building by $100,000.[6] In the present case, it is the $100,000 formula that yielded the statutory cover of $6.8 million paid by the Commission. In addition to compulsory insurance piggybacking on fire insurance, s 22 provides that those with insurable interests may enter into contracts of insurance against natural disaster damage with the Commission on a similar basis. Premiums in respect of both compulsory and voluntary insurance with the Commission are set by regulation and s 23 provides for their collection, in the case of compulsory insurance, by the insurer. The premiums at the relevant time were set by regulation at 5 cents plus GST per $100 of cover.[7]

[6] Against that statutory background, s 30 provides what is to happen where property is also insured "otherwise than under this Act":

> **30 Insurance otherwise than under this Act**
>
> (1) Where on the occurrence to any property of natural disaster damage against which it is insured under any of sections 18 to 20, or section 22, the property is also insured against that damage under any contract or contracts made otherwise than under this Act, the insurance of the property under this Act (to the amount to which it is so insured) shall be deemed to be in respect of so much of that natural disaster damage as exceeds the sum of—
>
> (a) the total amount payable under that contract or those contracts in respect of that natural disaster damage; and
>
> (b) the proportion of the natural disaster damage to be borne by the insured person under the conditions applying to the insurance of the property under this Act.

---

6 Earthquake Commission Act 1993, s 18(1).

7 Earthquake Commission Regulations 1993, reg 3(1).

(2) Subsection (1) shall not apply with respect to any contract of insurance made otherwise than under this Act to the extent that the contract provides for cover in excess of the amount to which cover is provided under this Act.

(3) Notwithstanding anything to the contrary in any contract whereby any property is insured against natural disaster damage otherwise than under this Act, where the property is or has at any time also been insured against that natural disaster damage under any of sections 18 to 20, or section 22, the contract shall have effect in all respects as if the property were not and had never been insured under this Act.

[7] The effect of these provisions seems to be as follows:

(a) Subsection (3) counters clauses, common in insurance contracts (and included in the policy here), that there must be recourse first to other insurance before a claim is made under the policy. Because of such provisions, s 30(3) is necessary to ensure the efficacy of subs (1). Notwithstanding such contractual provision, s 30(3) provides that the other insurance contract is to have effect as if the property were not insured under the Act.

(b) Subsection (1) establishes the general statutory rule that, where property is insured against natural disaster damage privately, the statutory insurance is available only for any excess not covered by the private insurance and then only up to the proportion the insured is required to meet himself under the compulsory insurance provisions: that is to say, the excess available is limited to a total of $100,000 per dwelling in the context of this case (or to such lesser limit contained in s 18).

(c) Subsection (2) permits what is "top-up insurance", that is to say insurance which is not an overlapping obligation to pay for the same natural disaster damage (and in respect of which ss 30(1) and (2) establish priorities by statute, favouring the Commission), but insurance structured to cover the additional loss not covered because of the cap on the statutory insurance by the Commission. There is no statutory policy in preventing insurance to cover that excess. The

equivalent to s 30(2) was first adopted by amendment to the Earthquake and War Damage Act 1944 when the statutory compensation was limited to indemnity value and policies for replacement value became available.[8] It now applies to permit private cover above the statutory cap since the move to replacement value in the statute.

Determination of the appeal

[8] In the present case, the parties were in agreement that the effect of cl MD15 was to bring the policy within the scope of s 30(2). That entails acceptance of the view that the policy does not cover natural disasters except by extension under cl MD15 (which is accordingly rightly located within the "Standard Policy Extensions to the Material Damage Section"). The extension is only in respect of the excess of loss after payment of the statutory cover. This seems to be the way in which the policy has been viewed by the Commission also, since it paid out the statutory cover without looking to Zurich, as would have been appropriate under s 30(1) if the policies had been overlapping. On that basis, the cover for which Zurich was contractually responsible was replacement value which exceeded the statutory cover, to the limit specified in the policy.

[9] In the Policy Certificate for the period of cover from 13 August 2010 to 13 August 2011 (the relevant period), the total sum insured for the property was $12.95 million made up of the reinstatement estimate of $11.6 million together with a provision for inflation of $575,000, and a demolition estimate of $775,000. The values identified had been provided by the Body Corporate in an insurance certificate which it had obtained from a valuer approved by the insurer. Under a special provision of the policy, the insurer was entitled to require such estimates on each renewal. Under the policy, the sum insured was to be not less than the estimate provided.

---

[8] The Earthquake and War Damage Amendment Act 1951 inserted s 14(2A), which provided that where an insured had purchased fire cover from a private insurer on a replacement basis, the statutory cover was for indemnity value only, and s 18(1A), which provided that, where cover under the Act was limited to indemnity value, s 18(1) did not apply to any policy with a private insurer "except to the extent to which the contract relates to the indemnity value or any part thereof".

[10] It is common ground that the replacement value of the buildings insured exceeds the sum of the statutory insurance and the full reinstatement sum insured of $12.95 million. The limit in the policy to replacement value does not of itself require the statutory insurance to be deducted from the reinstatement estimate to provide a net figure which further limits the amount for which the insurer is liable. Nor does any statutory policy support such limitation. Permitting those contracting for private insurance to achieve replacement value is a matter in the public interest, as s 30(2) suggests. Had the cover provided overlapped with the statutory cover, the insurer would have been responsible under s 30(1) for the full amount of the replacement value, despite cl GC09 of the agreement,[9] in application of s 30(3). It is not evident why such liability should be reduced because the compulsory payment precedes recourse to the top-up cover provided by the extension in the policy, as long as the replacement cost is not exceeded.

[11] Two arguments why the parties are to be taken objectively to have intended the additional limitation are put forward on behalf of Zurich. The first is that the premiums charged by Zurich were calculated on the basis that the sum insured was the net position after deduction of the Commission's statutory liability from the total replacement cost insured. This calculation of the basis on which the premium was calculated appears on the Policy Certificate for the 2009/2010 period of cover although not on the certificate for the period in issue. The second is that it is said to be anomalous if total destruction of the premises by fire would have resulted in the insured obtaining payment of $12.95 million, while destruction by earthquake would result in a payment of $19.75 million.

(a) The premium calculation in 2009

[12] The extension of cover to natural disaster loss did not restrict the sum insured to take account of payments from the Commission, as could readily have been accomplished. Rather, the extension of cover in its terms was to the excess of

---

[9] Clause GC09 provided: "If at the time of any Loss or Damage happening to any Property Insured, there be any other insurance or any cover effected by the Insured or by any other person, covering the same property or the Insured's interest therein, the insurance under this policy shall not apply until the full amount of cover under such other insurance has been exhausted in respect of the Insured's Loss or Damage.

replacement loss over the amount provided by the Commission up to the limit specified of $12.95 million.

[13] We are not persuaded that a contrary shared intention could properly be found in the Schedule setting out how the premiums charged were calculated, even if it is appropriate to apply to the 2010/2011 agreement the Schedule contained in the 2009 Policy Certificate. That is because impact on the extent of cover is not a point made in the certificate and it requires some effort and reconstruction to draw it out of a schedule produced for the different purpose of calculating the premium payable. No other contemporary indication of understanding that any payment by the Commission would be deducted from the liability of the insurer has been referred to.

[14] More importantly, the Schedule contained in the 2009/2010 Policy Certificate itself is readily explicable not as identifying a limitation on the insurer's liability arrived at through a necessary or agreed deduction of statutory payments, but as reflecting the valuation advice that had been accepted by Zurich for the purposes of calculating the premium. Zurich's expectation, based on the statutory limits of the liability of the Commission and the replacement valuation, was that it would not be exposed beyond $7.05 million. That expectation was an assessment of risk based on the valuations, not a matter of contractual limitation. The premium was calculated on the basis of the valuation and Zurich's assessment of its risk, not on the agreement of the parties that the cover provided by extension to the agreement to cover excess of loss over recovery from the Commission would itself be reduced by that recovery. The obligation of the insurer under cl MD15 did not arise until the Commission's payment had been made and there was a shortfall in the loss to the insured calculated on the basis of replacement value. It would be to rewrite the bargain the parties made to limit recovery of the excess in the way suggested by deducting the statutory payments from the replacement value limit contractually set. No adequate basis has been put forward to suggest that the parties intended such limitation. We see nothing absurd in a result which holds the insurer to the replacement value in the extended top-up cover contained in cl MD15.

(b) Additional recovery?

[15] It is, we think, to look at matters through the wrong lens to contrast the position of the insured if the loss had been a result of fire and the loss that has eventuated. In both cases, the insurer on the view we take would have been liable for the same amount, limited only by the insured sum. The insured cannot be said to have been unjustly enriched in recovering no more than the replacement value, as both parties intended the Body Corporate was to receive, up to the limit of the insurer's liability specified in the contract. It is true that in a case which has turned out to be one where the insured was underinsured, the statutory cover has reduced the loss the Body Corporate might have otherwise suffered. But what proper complaint about that result does the insurer have?

[16] We would allow the appeal. The majority being of the contrary view, however, the appeal is dismissed with costs of $25,000 plus reasonable disbursements to the first respondent for two counsel.

McGRATH, GLAZEBROOK and ARNOLD JJ

(Given by Arnold J)

Table of Contents

Introduction

[17] On 22 February 2011, Christchurch suffered a devastating earthquake. It caused widespread damage to land and buildings, including to Salisbury Park Apartments, a two-building complex comprising 68 unit-titled apartments. The second respondent, Body Corporate 398983, had insured the complex against material damage under a contract of insurance with the first respondent, Zurich Australian Insurance Ltd. The contract had been arranged on the Body Corporate's behalf by the appellant, a firm of brokers now known as Firm PI 1 Ltd but known at the relevant time as ACM Insurances Ltd (like the Courts below, we will refer to the firm as ACM).

[18] The contract provided cover on a replacement value basis. As at 22 February 2011, the buildings' reinstatement value was said to be $12.95 million.[10] This was on the basis of an estimate prepared by a firm of valuers, CB Richard Ellis Ltd (Richard Ellis), and was included in the contract as the sum insured for the buildings.[11] In fact, the reinstatement cost of the buildings was estimated to be around $22 million when these proceedings were issued in May 2012 and, as at February 2013, this estimate had increased to $25 million.

[19] As residences, the apartments in the complex were covered against natural disaster damage under the Earthquake Commission Act 1993 (the EQC Act). The Earthquake Commission (the EQC) has paid the Body Corporate the maximum statutory cover of $100,000 for each of the 68 residences – a total of $6.8 million. The question is whether, in addition to the EQC's payment, Zurich is liable to pay the full amount of reinstatement value as recorded in the contract, that is, $12.95 million, or whether it is liable to pay only the difference between the $6.8million that the Body Corporate has received from the EQC and the reinstatement value of $12.95 million, that is, $6.15 million. Succinctly put, the issue is whether the sum insured under the insurance contract for earthquake damage is inclusive or exclusive of the amount payable by the EQC.

---

[10] This figure excludes GST, as do the other figures given in this judgment.

[11] In this respect, the contract in issue in the present case is different to that at issue in *Ridgecrest NZ Ltd v IAG New Zealand Ltd* [2014] NZSC 129.

[20] The answer turns primarily on the interpretation of cl MD15 in the insurance contract, which provided that where the statutory cover applied "the Insurer[']s liability will be limited to the amount of loss in excess of [the statutory cover]".

Factual background

[21] The Salisbury Park Apartments complex comprised two buildings containing a total of 68 apartments and was completed in 2008. Initially it was insured with NZI Insurance Ltd. However, in 2009, ACM went to the market seeking quotes for material damage cover, including what was referred to as "top up" earthquake cover. It is accepted that ACM acted as the Body Corporate's agent throughout and was an "agent to know".[12] ACM went to the market on the basis that the cover would be on policy wording prepared by Brokernet. Brokernet is a group of independent brokers (including ACM) who have worked together to prepare their own policy wordings.

[22] Having received several quotes, ACM wrote to the Body Corporate on 1 July 2009 recommending that the Body Corporate accept Zurich's quote. The Body Corporate accepted ACM's recommendation in writing on 22 July 2009.

[23] Under the terms of the Brokernet policy, the Body Corporate was required to provide Zurich with a written estimate of the buildings' reinstatement cost "made and certified by a Valuer acceptable to [Zurich]". The Body Corporate submitted an insurance certificate dated 20 May 2009 which it had obtained from Richard Ellis. That gave an overall figure of $13.85 million, comprising a reinstatement estimate of $11.55 million, an inflationary provision of $1.57 million and a demolition estimate of $730,000. In the letter to the Body Corporate that accompanied the certificate, Richard Ellis noted that the valuation figures "relate purely to the establishment of an adequate insurance cover". The letter went on to say:

> Earthquake cover previously offered by the Earthquake Commission is no longer available in many instances. In order to remain fully covered for all property losses you will need to purchase additional insurance and we recommend that you discuss the purchase of "top up" earthquake insurance cover with your broker or insurer.

---

[12] *Body Corporate 398983 v Zurich Australian Insurance Ltd* [2013] NZHC 1109 (Courtney and Heath JJ) at [68] [*Zurich* (HC)]; and *Zurich Australian Insurance Ltd v Body Corporate 398983* [2013] NZCA 560, [2014] 3 NZLR 289 (Ellen France, White and Miller JJ) at [16] [*Zurich* (CA)].

[24] Once it had received the Body Corporate's written confirmation that it accepted the recommendation, ACM sent an important three-page document to Zurich confirming cover. We will set out the terms of this document in more detail once we have described the terms of the policy.

The policy

[25] The policy document opens with the words:

> This Policy is not a completed contract unless attaching a completed Brokernet Policy Certificate which together shall be read as one contract.
>
> In consideration of the Insured agreeing to pay to the Insurer the premium stated, the Insurer agrees to provide the Insured the cover set out in this Policy.

The term "Brokernet Policy Certificate" is defined in the definition section of the policy to be "the certificate attaching to and forming part of this policy".

[26] There are throughout the policy references to the Brokernet Policy Certificate (the certificate). In particular, reference must be made to the certificate to identify matters such as:

(a) the insured;

(b) the insurer;

(c) the location of the insured property;

(d) the period of insurance;

(e) the sums insured;

(f) the basis for settlement of some losses;

(g) any excesses; and

(h) whether particular optional clauses were included in the policy.

So, for example, the term "sum insured" is defined in the policy to be "the limit of the Insurer's liability as stated in the Brokenet Policy Certificate for any one Loss or Damage".

[27] Three clauses of the material damage section of the policy are of particular relevance, namely the insuring clause, cl MD15 and cl MD25. The insuring clause provides:

> The Insurer agrees to cover the Insured for all Loss or Damage to the Property Insured during the Period of Cover due to an Event.
>
> Provided that the liability of the Insurer, for any one Loss or Damage under this section, shall not exceed the Sum Insured as stated or endorsed onto this policy ….

The capitalised words are defined terms.[13] Relevantly, an "Event" is something "which results in Loss or Damage". "Loss or Damage" is "physical loss of or damage to the Property Insured, that is unintended or unforeseen by the Insured".

[28] Clause MD15 deals with natural disaster damage. It provides:

> **MD15 NATURAL DISASTER DAMAGE**
>
> In the event of the Insured having insured residential property for which compulsory Natural Disaster Damage cover under the Earthquake Commission Act 1993 applies then in the event of such property suffering Natural Disaster Damage during the Period of Cover and covered by Natural Disaster Damage cover, then the Insurer[']s liability will be limited to the amount of loss in excess of the Natural Disaster Damage cover.

"Natural Disaster Damage" is defined in the policy to have "the meaning given to it in the Earthquake Commission Act 1993 or any replacement legislation". To determine whether property is covered under cl MD15, reference must be made to the certificate.

[29] As the Court of Appeal noted, the policy was unlike many in use in New Zealand in that it did not contain an express exclusion of liability in respect of natural disaster damage, with the option of adding such cover by means of an

---

[13] Although generally capitalised where it appears, the word "Policy" is not defined in the definition section, but must, as a result of the opening words of the policy, be interpreted to include the Brokernet Policy Certificate.

extension.[14] Despite the absence of an express exclusion, however, cl MD15 did appear in a part of the policy headed "Standard Policy Extensions to the Material Damage Section". The policy provided that, if an extension conflicted or was inconsistent with any other term (other than a general exclusion), the extension would prevail.

[30] Clause MD25, which also appears in the standard extensions section of the policy, deals with replacement cover. It provides:

> **MD25 REPLACEMENT VALUE**
>
> In the event of Loss or Damage to Property Insured by this Extension the amount payable by the Insurer under this section of the policy is to be the cost of reinstatement of such property where stated in the Brokernet Policy Certificate as the Basis of Settlement.

This was, however, subject to certain definitions and special provisions. The special provisions are relevant in two respects. First, special provision 1 imposed the requirement that the insured provide the insurer with a written estimate of the cost of reinstatement of the insured property "made and certified by a Valuer acceptable to the Insurer". It went on to provide that the sum insured could not be less than the amount of the estimate. Second, other special provisions made it clear that the insurer's liability could not exceed the sum insured.

[31] Against this background, we turn to the certificate.

The Brokernet certificate

[32] It was common ground that the three page document referred to at para [24] above should be treated as the certificate for the purposes of the policy effected for the period 13 August 2009 to 13 August 2010, which was the first period for which Zurich provided cover. The document is addressed to Zurich and is marked "Underwriter's Copy". Some of the language in the document is directed towards the insured (in particular, in relation to the duty of disclosure).

---

[14] *Zurich* (CA), above n 12, at [19].

[33] The document begins by setting out, among other things, the names of the client (of ACM) and the insurer and the period of insurance cover. Under the heading "Cover" the document says:

> The amounts shown under "Insurance Schedule – What You Have Covered", are the Sums Insured declared by the Insured for insurance purposes. Except where expressly provided to the contrary under the policy, the liability of the Insurer for Loss or Damage to any item of Property Insured will not exceed the Sums Insured.
>
> This is a summary schedule only, and the Policy is subject to the Brokernet Policy Terms, Conditions and Exclusions.

[34] Under "Insurance Schedule – What You Have Covered" the document reads:

> Buildings – Replacement Value $13,850,000.

This, then, is the sum insured. The document goes on to identify the excesses applicable to different types of cover and to list the standard policy extensions and extra covers. It then includes a table setting out the basis for the premium calculation. Because of its importance, we reproduce it in the form it appears in the document:

Premium Calculation

	$ Value	% Rate	% Mult	$ Premium
C Reinstatement	$ 11550000	0.0500		$ 5775.00
C INF	$ 1570000	0.0500	70.00	$ 549.50
C Demo	$ 730000	0.0500		$ 365.00
Q 68 Units	$ 6800000	0.0500		$ 3400.00
E RV less EQC	$ 4750000	0.0183		$ 869.25
E Inf Provision	$ 1570000	0.0183	70.00	$ 201.12
E Demo	$ 730000	0.0183		$ 133.59
F FSL	$ 6800000	0.0760		$ 5168.00
C Site Improvements	$ 100000	0.0500		$ 50.00
E Site Improvements	$ 100000	0.0200		$ 20.00

[35] The replacement value of $13.85 million is the total of the first three items in the "$ Value" column of the table: the reinstatement value of the buildings at the commencement of the insurance period, an inflationary provision to take account of the fact that the loss could occur at the end of the insurance period and an amount to cover the cost of demolishing the damaged buildings (assuming total loss). All of these figures were based on the estimates provided in Richard Ellis's valuation of 20

May 2009. The $13.85 million figure is the total sum insured under the policy and represents the limit of Zurich's liability.

[36] The next four items in the table deal with natural disaster. The entry of "68 Units" beside the letter "Q" is the maximum amount available under the cover provided by the EQC Act, that is, $100,000 multiplied by 68 residential units, giving a total of $6.8 million. The next entry, "RV less EQC", identifies the sum remaining after the EQC's $6.8 million is deducted from the reinstatement value of $11.55 million, namely $4.75 million. The next two entries repeat the inflationary provision and demolition costs. As the table indicates, Zurich's premium in relation to natural disaster damage coverage was calculated by reference to these three figures, which totalled $7.05 million. The total of the four entries relating to natural disaster in the "$ Value" column of the table is the sum insured of $13.85 million (ie, $6.8 million plus $7.05 million). Finally, we note that the last two entries provide cover of $100,000 for site improvements for non-natural disaster and natural disaster damage respectively, for the identified premiums. We will discuss the significance of the Schedule's contents later in this judgment.[15]

[37] When ACM sought quotes from Zurich, what it received were the figures to go in the "% Rate" column of the table. Zurich quoted two figures: 0.050% for non-natural disaster damage cover (that is, 5 cents per $100) and 0.020% for "Top Up EQC" natural disaster damage cover. Following negotiation with ACM, Zurich reduced its figure for natural disaster damage cover to 0.0183%. ACM then inserted these figures into its template premium calculation sheet to produce the premiums payable. Although laid out rather differently, ACM's premium calculation sheet was, in material respects, identical to the table reproduced at para [34] above, except that the column headed "$ Value" in the table was headed "Sum Insured" in the calculation sheet. (Evidence was given on behalf of Zurich that ACM provided its premium calculation sheet to Zurich when placing the cover to enable Zurich to check the premium calculation).

[38] When the time for renewal of the policy was approaching, ACM sought quotes from several insurers including Zurich. Under cover of letter dated

---

[15] See [68]–[70] below.

14 June 2010, Richard Ellis had provided an updated insurance certificate for the apartment complex. It gave a reinstatement estimate of $11.6 million, an inflationary provision of $575,000 and a demolition estimate of $775,000, giving a total replacement value of $12.95 million, a reduction from the previous year. Zurich quoted 0.0625% for non-natural disaster damage cover and 0.0183% for natural disaster damage cover. Zurich's quote was accepted and ACM entered the percentage figures into its template to calculate the premiums, although, as in the previous year, it invoiced the Body Corporate for a premium that was slightly higher than the figure produced by the calculation.

[39] As with the table in the certificate for the 2009/2010 year, ACM's template calculated the premium for non-natural disaster cover on the basis of the three figures provided by Richard Ellis and the premium for natural disaster cover on the basis of deducting the $6.8 million available from the EQC from the reinstatement estimate of $11.6 million and then adding in the premiums for the inflationary provision and the demolition costs. As with the previous year, these various figures were set out in a column in ACM's template headed "Sum Insured". However, the certificate for the 2010/2011 year does not appear to have included any table with a breakdown of the premium calculation such as that contained in the certificate relating to the 2009/2010 year.

The February 2011 earthquake

[40] The 22 February 2011 earthquake severely damaged one of the Body Corporate's two apartment blocks, to the point that it had to be demolished. The other block was less seriously damaged and remained habitable, although in need of repair. The Body Corporate took the view that it was a constructive total loss as it was uneconomic to repair. When this litigation was commenced, Zurich had not made a decision on that point. For the purposes of this appeal, we will treat both buildings as having suffered total loss as a result of the earthquake.

[41] The Body Corporate determined that it wished to rebuild on the existing site. At that point, it became apparent that the reinstatement estimate provided by Richard

Ellis was inaccurate and that reinstatement of the complex would cost something in the order of $25 million. That gave rise to the current proceedings.

The proceedings

[42] In May 2012, the Body Corporate issued proceedings against both Zurich and ACM. The Body Corporate's principal claim is that Zurich agreed with ACM to provide the Body Corporate with material damage cover in the amount of $100 million. A secondary claim is that, on the assumption that the sum insured under the policy is $12.95 million, Zurich's liability under cl MD15 in respect of natural disaster damage is in addition to the sum that the Earthquake Commission is obliged to pay under the statutory cover rather than net of it.

[43] The parties agreed that the following preliminary question should be determined:

> Is the Sum Insured for buildings under the material damage section of the contract of insurance between the [Body Corporate] and [Zurich] in respect of the Salisbury Apartments inclusive or exclusive of all amounts payable to the [Body Corporate] from the Earthquake Commission as Natural Disaster Damage cover under the Earthquake Commission Act 1993 for Natural Disaster Damage to the buildings from the 22 February 2011 earthquake?

For the purposes of the hearing of this question, it was assumed that the sum insured for buildings under the policy was $12.95 million. The question was addressed on the basis of affidavit evidence, which had been heavily redacted. There was no cross-examination.

[44] In the High Court,[16] Heath and Courtney JJ found for the Body Corporate, for two principal reasons. The first was that they saw an anomaly between the position under s 30(1) and (3) of the EQC Act and the position under s 30(2) if Zurich's interpretation was correct.[17] In the absence of cl MD15, s 30(1) would have applied. Section 30(1) required that Zurich's cover be exhausted before the statutory cover applied. As a consequence, given an overall loss of $25 million, the Body Corporate would have received the sum insured of $12.95 million from Zurich and could then have obtained a further $6.8 million from the Commission, for a total of

---

16 *Zurich* (HC), above n 12.

17 These provisions are set out at [53]–[55] below.

$19.75 million. On Zurich's interpretation of cl MD15, however, the Body Corporate would have received only $12.95 million, comprised of $6.8 million from the Commission and $6.15 million from Zurich. The Court thought it would be a "most unusual result" if the amount for which Zurich was liable, differed depending on whether the statutory cover or private insurance was drawn on first.[18]

[45] The second reason for the Court's conclusion was the plain wording of cl MD15. Their Honours interpreted "loss" to mean the actual loss suffered by the Body Corporate, whether insured or uninsured, that is, $25 million.[19] Clause MD15 did not further limit Zurich's liability beyond the limit provided for by means of the sum insured.

[46] The High Court held that ACM knew, based on its market experience, that the premium for natural disaster damage cover had been calculated on the basis of the difference between the statutory cover and the limit of liability in the policy.[20] The Body Corporate was fixed with ACM's knowledge and, therefore, the premium calculation was part of the factual matrix for the purposes of contractual interpretation.[21] Ultimately, however, the Court was not satisfied that its interpretation, based on what it considered to be the plain wording of cl MD15, produced such an "unacceptable commercial result" as to warrant a different approach.[22]

[47] The Court of Appeal allowed Zurich's appeal.[23] It considered that the words in cl MD15 that "the Insurer's liability will be limited to" the amount of loss in excess of the statutory cover indicated that the clause set a limit on Zurich's liability which was different to the limit that would otherwise apply. That different limit could only be the difference between the statutory cover and the sum insured.[24] Moreover, the Court considered that the High Court gave insufficient weight to the commercial context of the policy. That context established that the parties had

---

18 *Zurich* (HC), above n 12, at [15]–[18].
19 At [26].
20 At [45]–[46].
21 At [68]–[69].
22 At [82].
23 *Zurich* (CA), above n 12.
24 At [39].

intended to limit Zurich's liability for natural disaster damage to the difference between the amount obtained under the statutory cover and the sum insured.[25]

[48] This Court then granted leave to appeal on the preliminary question.[26]

[49] Before we turn to discuss the issues in the case we need to say something about the statutory context.

Statutory context

[50] Two statutes are relevant – the EQC Act and the Unit Titles Act 1972.[27] We address each in turn.

Earthquake Commission Act 1993

[51] Under s 18 of the EQC Act, a person who takes out a fire insurance policy in respect of a residential property is deemed, while the policy remains in force, to have statutory cover for natural disaster damage. Under s 18(1), the maximum cover available is $100,000 per residence. Section 27 provides that the cover provided under the EQC Act will be subject to the conditions set out in sch 3. Schedule 3 deals with a number of matters, including the circumstances in which the Commission may decline or meet only part of a claim.

[52] The definition of "natural disaster damage" in the EQC Act, which is incorporated into the policy, is as follows:[28]

> **natural disaster damage** means, in relation to property,—
>
> (a) any physical loss or damage to the property occurring as the direct result of a natural disaster; or
>
> (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

---

25 At [42]–[43].

26 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 19.

27 The Unit Titles Act 1972 was the applicable Act at the relevant time. It has now been repealed and replaced by the Unit Titles Act 2010.

28 Earthquake Commission Act 1993, s 2, definition of "natural disaster damage" [EQC Act].

> physical loss or damage to the property for which compensation is payable under any other enactment[.]

"[N]atural disaster" is defined as meaning:[29]

> (a) an earthquake, natural landslip, volcanic eruption, hydrothermal activity, or tsunami; or
>
> (b) natural disaster fire; or
>
> (c) in the case only of residential land, a storm or flood[.]

"Natural disaster fire" means:[30]

> fire occasioned by or through or in consequence of an earthquake, natural landslip, volcanic eruption, hydrothermal activity, tsunami, or (in the case only of residential land) a storm or flood[.]

[53] Section 30 of the EQC Act deals with the situation where an insured has cover for natural disaster damage both under the statute and through private insurance. Section 30(1) sets out the basic rule where there is double insurance, namely that the statutory cover responds *after* the private cover (including any deductible) has been exhausted. Section 30(1) provides:

> Where on the occurrence to any property of natural disaster damage against which it is insured under any of sections 18 to 20, or section 22, the property is also insured against that damage under any contract or contracts made otherwise than under this Act, the insurance of the property under this Act (to the amount to which it is so insured) shall be deemed to be in respect of so much of that natural disaster damage as exceeds the sum of—
>
> (a) the total amount payable under that contract or those contracts in respect of that natural disaster damage; and
>
> (b) the proportion of the natural disaster damage to be borne by the insured person under the conditions applying to the insurance of the property under this Act.

[54] Section 30(1) must be read with section 30(3). That provides that where there is double insurance, the private cover is to respond as if the property was not covered under the EQC Act. Presumably this is to prevent any double insurance provision in the private insurance policy from taking effect. Section 30(3) provides:

---

[29] Section 2, definition of "natural disaster".
[30] Section 2, definition of "natural disaster fire".

> Notwithstanding anything to the contrary in any contract whereby any property is insured against natural disaster damage otherwise than under this Act, where the property is or has at any time also been insured against that natural disaster damage under any of sections 18 to 20, or section 22, the contract shall have effect in all respects as if the property were not and had never been insured under this Act.

[55] These two subsections can be traced back to s 18 of the Earthquake and War Damage Act 1944. They must be read, however, in light of s 30(2), which provides:

> Subsection (1) shall not apply with respect to any contract of insurance made otherwise than under this Act to the extent that the contract provides for cover in excess of the amount to which cover is provided under this Act.

The effect of this subsection is that where an insured purchases cover from a private insurer for loss resulting from natural disaster in excess of that compensated for under the statutory cover, the insured will be entitled to call on the statutory cover before calling on the private cover. In other words, the effect of s 30(1) can be avoided. The parties were in agreement that cl MD15 was effective to bring the present policy within the scope of s 30(2).

[56] Section 30(2) was introduced into the Bill at the Select Committee stage in response to concerns that the Bill as drafted might not make it sufficiently clear that it was permissible to purchase cover for natural disaster damage in excess of that provided under the EQC Act.[31] In fact, amendments had been made to the Earthquake and War Damage Act 1944 in 1951 to address the increasing practice of people in the business community taking out fire cover on a replacement rather than an indemnity basis.[32] Section 14(2A) was added to make it clear that where an insured had purchased fire cover from a private insurer on a basis more favourable than indemnity value, the statutory cover was for indemnity value only, although the Earthquake and War Damage Commission did have the power under s 15 to offer cover on different terms including, presumably, in excess of indemnity value.[33] Section 18(1A) was also inserted,[34] which provided that, where cover under the Earthquake and War Damage Act was limited to indemnity value, s 18(1) (the

---

31 Earthquake Commission Bill 1992 (210-2). See also Insurance Council of New Zealand, "Submission on the Earthquake Commission Bill" 22 February 1993.

32 See (28 November 1951) 296 NZPD 1146–1147.

33 Earthquake and War Damage Amendment Act 1951, s 2(1). We do not know whether the Commission ever exercised this power.

34 Earthquake and War Damage Amendment Act, s 2(3).

equivalent of s 30(1) of the EQC Act) did not apply to any policy with a private insurer "except to the extent to which the contract relates to the indemnity value or any part thereof". The effect of this was to recognise that an insured could take out cover for natural disaster damage for the difference between the indemnity and replacement values of a property.

[57] By contrast to the indemnity cover provided by the Earthquake and War Damage Act, from the introduction of the EQC Act, the statutory cover was for replacement value, but subject to the cap of $100,000 per residence.

Unit Titles Act 1972

[58] Sections 15(1)(b) and (c) of the Unit Titles Act required the Body Corporate to:[35]

> (b) insure and keep insured all buildings and other improvements on the land to the replacement value thereof (including demolition costs and architect's fees) against fire, flood, explosion, wind, storm, hail, snow, aircraft and other aerial devices dropped therefrom, impact, riot and civil commotion, malicious damage caused by burglars, *and earthquake in excess of indemnity value*: [and]
>
> (c) effect such other insurance as it is required by law to effect or as it may consider expedient[.]

[59] Section 15(1)(b) was inserted in 1979 in response to problems that had arisen in relation to the insurance of unit-titled apartment blocks.[36] Among other things, it required bodies corporate to purchase natural disaster damage insurance for the difference between the indemnity and replacement values of the property, reflecting the fact that cover under the Earthquake and War Damage Act was for indemnity value only and that top up cover could be purchased. Section 15(1)(b) was not updated when the EQC Act came into effect in 1993 to reflect the fact that cover under that Act is on a replacement basis but to a limit of $100,000 per residence.

---

35 (Emphasis added).
36 (14 June 1979) 422 NZPD 760–761.

Analysis

[60] Given the issues in the case, it is not necessary that we discuss the approach to contractual interpretation in any detail. It is sufficient to say that the proper approach is an objective one, the aim being to ascertain "the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract".[37] This objective meaning is taken to be that which the parties intended.[38] While there is no conceptual limit on what can be regarded as "background",[39] it has to be background that a reasonable person would regard as relevant.[40] Accordingly, the context provided by the contract as a whole and any relevant background informs meaning.

[61] The requirement that the reasonable person have all the background knowledge known or reasonably available to the parties is a reflection of the fact that contractual language, like all language, must be interpreted within its overall context, broadly viewed. Contextual interpretation of contracts has a significant history in New Zealand, although for many years it was restricted to situations of ambiguity.[41] More recently, however, it has been confirmed that a purposive or contextual interpretation is not dependent on there being an ambiguity in the contractual language.[42]

---

37 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 912 per Lord Hoffmann. See also *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 at [14] per Lord Hoffmann.

38 *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988 at [16] per Lord Hoffmann delivering the judgment of the Privy Council.

39 Subject to the exception in relation to evidence of pre-contract negotiations: see n 42 below.

40 *Bank of Credit and Commerce International SA v Ali* [2001] UKHL 8, [2002] 1 AC 251 at [39] per Lord Hoffmann.

41 See *Blakely and Anderson v De Lambert* [1959] NZLR 356 (SC & CA) at 367 per FB Adams J (in the Supreme Court) and at 387 per Cleary J (delivering the judgment of the Court of Appeal); and *Eastmond v Bowis* [1962] NZLR 954 (SC) at 958–959 per Richmond J. See also *Benjamin Developments Ltd v Robt Jones (Pacific) Ltd* [1994] 3 NZLR 189 (CA) at 196 per Casey J.

42 See *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [4] per Blanchard J, at [23] per Tipping J, at [64] per McGrath J and at [151] per Gault J. (As the present case does not raise any issue as to the admissibility of pre-contractual negotiations, we do not address that aspect of the *Vector* decision). Interestingly, there is some suggestion, in recent decisions of the United Kingdom Supreme Court that an ambiguity might be required: see, for example, *Rainey Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900 at [21] and [23] per Lord Clarke. See also *Barts and the London NHS Trust v Verma* [2013] UKSC 20 at [26] per Lord Carnwath.

[62] It should not be over-looked, however, that the language of many commercial contracts will have features that ordinary language (even a "serious utterance"[43]) is unlikely to have, namely that it will result from a process of negotiation, will attempt to record in a formal way the consensus reached and will have the important purpose of creating certainty, both for the parties and for third parties (such as financiers).[44] The fact that parties are aware their contract might be relied upon by a third party may justify a more restrictive approach to the use of background in some instances, the parties' awareness being itself part of the relevant background.[45] In *Re Sigma*, where the interpretation of security trust deed was in issue, Lord Collins said that the background was not relevant "except in the most generalised way" and went on to say:[46]

> Where a security document secures a number of creditors who have advanced funds over a long period it would be quite wrong to take account of circumstances which are not known to all of them. In this type of case it is the wording of the instrument which is paramount. The instrument must be interpreted as a whole in the light of the commercial intention which may be inferred from the face of the instrument and from the nature of the debtor's business. Detailed semantic analysis must give way to business common sense … .

To some extent, then, the scope for resort to background is itself contextual. We also note at this point that Lord Collins' reference to "business common sense" is one that is echoed in many interpretation cases, as we discuss at paras [77]–[79] and [88]-[93] below.

[63] While context is a necessary element of the interpretive process and the focus is on interpreting the document rather than particular words, the text remains centrally important. If the language at issue, construed in the context of the contract as a whole, has an ordinary and natural meaning, that will be a powerful, albeit not conclusive, indicator of what the parties meant.[47] But the wider context may point to

---

43 *Investors Compensation Scheme*, above n 37, at 912 per Lord Hoffmann.

44 For further discussion see JW Carter *The Construction of Commercial Contracts* (Hart Publishing, Oxford, 2012) at [5.07]–[5.17].

45 Matthew Barber and Rod Thomas "Contractual Interpretation, Registered Documents and Third Party Effects" (2014) 77 MLR 597 at 615. See also *Chartbrook*, above n 37, at [40] per Lord Hoffmann.

46 *Re Sigma Finance Corp (in admin rec)* [2009] UKSC 2, [2010] 1 All ER 571 at [37] per Lord Collins. Lord Hope and Lord Mance concurred with Lord Collins' judgment.

47 We deal with the situation where something may have gone wrong with the contractual language later in this judgment: see [88]–[93] below.

some interpretation other than the most obvious one and may also assist in determining the meaning intended in cases of ambiguity or uncertainty.

[64] Against this background, we will begin by assessing cl MD15 in its contractual context and then move on to consider whether the structure of the bargain, any specialised meaning, or considerations of commercial absurdity affect that assessment.

Clause MD15 in its contractual context

[65] We begin with the disputed clause, cl MD 15, viewed in its contractual setting. For ease of reference we set the clause out again:[48]

> **MD15 NATURAL DISASTER DAMAGE**
>
> In the event of the Insured having insured residential property for which compulsory Natural Disaster Damage cover under the Earthquake Commission Act 1993 applies then in the event of such property suffering Natural Disaster Damage during the Period of Cover and covered by Natural Disaster Damage cover, then *the Insurer[']s liability will be limited to the amount of loss in excess of the Natural Disaster Damage cover*.

[66] The question is whether cl MD15 means that the limit of Zurich's liability for natural disaster cover is to be calculated on the basis that any amount received from EQC is included or excluded. At this point, we are simply attempting to ascertain the meaning of the clause, interpreted in the context of the contract as a whole – we discuss relevant features of the wider background later. Our approach is that of the reasonable person, but taking account of the fact that the parties were an insurer and an insurance broker (acting for the insured): the "background knowledge which would reasonably have been available to [both] parties" therefore includes a significant level of understanding of insurance and insurance policies. The policy wording is that of the broker, which means that, if there were reason to call in aid the contra proferentem rule, it would operate against the broker.[49]

[67] Standing alone, cl MD 15 can be interpreted as not imposing any limit on Zurich's liability other than in terms of the Body Corporate's actual loss, in this case

---

[48] (Emphasis added).

[49] See *DA Constable Syndicate 386 v Auckland District Law Society Inc* [2010] NZCA 237, [2010] 3 NZLR 23 at [69] for discussion of the contra proferentem rule.

$25 million. But the clause must be read in the context of the contract as a whole, which means, at least, that the overall limit represented by the sum insured applies. But does the clause go further? The Court of Appeal considered that the use of the words "will be limited to" indicated that a further limitation was intended, namely a limitation to the difference between the amount recovered from EQC and the sum insured.[50]

[68] When the contract of insurance is read as a whole, we consider that interpretation to be correct. For the first year that Zurich provided cover (2009/2010), the insurance contract comprised the policy and the certificate. The certificate makes it clear that the natural disaster cover provided by Zurich is for the difference between what is paid by the EQC and the sum insured under the policy. This is because the table containing the premium calculation clearly identifies the dollar value of the cover being purchased by the relevant premium.[51]

[69] To explain, in relation to non-natural disaster, the total of the first three entries in the "$ Value" column is $13.85 million, which was the sum insured under the contract. The total premium attributable to that cover was $6,689.50 (or $6,739.50 if the premium for the site improvement allowance is included). Turning to natural disaster cover, the maximum statutory cover available under s 14 of the EQC Act was $100,000 per unit or $6.8 million in total; the premium payable for that was set by regulations at 5 cents per $100 of cover.[52] The table contains that calculation – the statutory cover available is set out in the "$ Value" column and the percentage figure (0.050%) is applied to that to produce the premium. Similarly in relation to the natural disaster cover purchased from Zurich. The cover purchased is identified in the "$ Value" column. It was $7.05 million, which was the sum of (1) $4.75 million, being the difference between the reinstatement estimate and the amount payable by the EQC, (2) $1.57 million, being the inflation provision and (3) $0.73 million, being the provision for demolition.[53] Because the certificate is part of the contract of insurance, cl MD15 must be interpreted consistently with it.

---

50 *Zurich* (CA), above n 12, at [39].

51 See the table reproduced at [34] above and the column headed "$ Value".

52 Earthquake Commission Regulations 1993, reg 3. In 2011, this regulated rate was amended to 15 cents for every $100.

53 The total premium attributable to natural disaster cover also included $20 for the site improvement allowance.

Accordingly, the clause must be interpreted as providing natural disaster cover for the difference between the sum insured and the amount available under the EQC Act, that is $7.05 million.

[70] For the following year (2010/2011), which was the year in which the claim arose, the relevant figures changed although the means of calculation remained the same, so that the difference between the amount available from the EQC ($6.8 million) and the total sum insured under the policy ($12.95 million) was $6.15 million rather than $7.05 million. While the certificate for that year does not appear to have included a table such as that contained in the certificate for the 2009/2010 year, there is no basis for interpreting the language of cl MD15 differently given that it was unchanged. The certificate from the first year of cover is part of the relevant background to the contract for the 2010/2011 year.

[71] In light of this, we interpret cl MD15 as follows. As we have noted, the phrase "Loss or Damage" in the contract is defined to mean "physical loss of or damage to the Property Insured, that is unintended or unforeseen by the Insured". This phrase covers all the material damage suffered by the Body Corporate's buildings as a result of the earthquake to whatever value. The replacement value of the buildings, which became the sum insured and was the limit of Zurich's liability under the contract, was the sum fixed by the contractual process as the amount which the Body Corporate would be entitled to receive on a total loss of their buildings. Whether that total loss occurred as a result of non-natural or natural disaster would have been irrelevant. The word "loss" in the sentence "the Insurer[']s liability will be limited to the amount of loss in excess of the Natural Disaster Damage cover" in cl MD15 is not capitalised, indicating that it is not a defined term and so must have been used in a different sense than "Loss or Damage". In combination with the words "limited to", we consider that "loss" means the Body Corporate's net loss, that is, the loss remaining after any payment from the EQC has been deducted from the overall limit provided by the sum insured. This difference between the amount available from the EQC and the limit of liability in the contract is the Body Corporate's "loss", which Zurich is obliged to cover. Combined, the two amounts are the replacement value that the parties agreed would represent the Body Corporate's loss in the event of total destruction of their buildings. As we develop in

the next section of the judgment, we consider that this interpretation accords not only with the language of cl MD15 but also with the structure of the parties' bargain, particularly as to who carried the risk of under-insurance.

[72] Mr Ring QC argued that it could not be assumed that because Zurich calculated its company earthquake premium on $6.15 million, it necessarily followed that both parties objectively intended that this figure would be Zurich's maximum liability in the event that the Body Corporate suffered natural disaster damage. He submitted that the percentage figure provided by Zurich and the figure by which it was multiplied in the premium calculation were arbitrary as the premium calculation was ultimately a matter of commercial negotiation. Mr Ring noted that additional items were included in the cover without any separately identifiable premium being charged (in particular, owners' fixtures and fittings of unfurnished accommodation up to a maximum of $15,000 per unit and 12 months loss of rental income and payable operating expenses, up to a maximum of $25,000 per unit), and that these might have the effect of extending Zurich's liability beyond $6.15 million. He submitted that, on Zurich's interpretation, Zurich would have a greater liability where one building was destroyed than it would have where two were destroyed.[54]

[73] In some cases, the mechanics of premium calculation may provide little assistance in determining the scope of cover provided in an insurance policy. In the present case, however, part of the insurance contract, the certificate, specifically identified the cover that the premium was intended to purchase. The method of calculation was known to both parties, with the insurer providing two critical inputs, namely the percentage rates for non-natural and natural disaster cover, and the broker completing the calculations on the basis of the declared replacement value. There is no dispute that the amount of non-natural disaster cover that the relevant premium was intended to purchase was, in the 2010/2011 year, a total of $12.95 million, as set out in ACM's calculation sheet. Nor is it disputed that the premium paid to the EQC was intended to purchase $6.8 million of statutory cover, as set out in ACM's calculation sheet. We think it implausible to suggest that the only premium in ACM's calculation sheet that was not intended to purchase the cover identified alongside it was the premium in relation to Zurich's natural disaster cover. When the

[54] We address this point at [94]–[95] below.

language of cl MD15 is read in the context of the whole contract, it must be interpreted in a way that gives effect to what was, on an objective assessment, clearly intended.

[74] As to Mr Ring's point that Zurich provided cover for some items in respect of which it did not charge any separately identifiable premium, those additional items are specifically identified in the certificate, apply to both non-natural and natural disaster damage cover and serve simply to reinforce the certificate's contractual importance.

[75] Mr Ring identified other features of the policy which he argued were inconsistent with Zurich's argument. In particular, he noted that cl MD15 appeared in the standard extensions section of the policy, yet on Zurich's interpretation, cl MD15 limited Zurich's liability rather than extended it. As we have mentioned, the contract did not exclude liability in respect of natural disaster damage, with the option of taking an extension, as occurs in many material damage policies. As a consequence, on Zurich's argument, cl MD15 would operate to limit Zurich's liability further than would be the case in its absence. However, as Mr Goddard QC noted, other provisions in the extensions section of the policy are not in fact extensions but deal with other matters (for example, the reinstatement of insurance after a covered event) or impose limits (by, for example, treating loss or damage arising from a series of events as arising from a single event in certain circumstances). Accordingly, while most of the provisions in the section are extensions, that is not true of all of them. As a consequence, the location of cl MD15 in the extensions section does not provide assistance.

[76] In the result, we are satisfied that the language of cl MD15, read in the context of the whole contract, does provide an additional limit on Zurich's liability, so that Zurich's liability in relation to earthquake damage to the Body Corporate's buildings is limited to the difference between the amount paid by the EQC and the sum insured in the policy.

General structure of the bargain

[77] Sir Kim Lewison has observed:[55]

> In the course of the last five decades the court has increasingly sought to elucidate the commercial purpose of the contract under consideration, and as between competing interpretations to select that meaning which best serves the commercial purpose of the contract, as perceived by the court.

[78] Besides what was said by Lord Collins in *Re Sigma*, to which we have already referred,[56] there are many statements in the authorities supporting this proposition. For example:

(a) Lord Diplock said in *Antaios Compania Naviera SA v Salen Rederierna AB*:[57]

> … if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense.

(b) In *Mannai Investment Co Ltd v Eagle Star Assurance Co Ltd*, Lord Steyn noted that there had been "a shift from strict construction of commercial instruments to what is sometimes called purposive construction".[58] His Lordship went on to say:[59]

> In determining the meaning of the language of a commercial contract, and unilateral contractual notices, the law … generally favours a commercially sensible construction. The reason for this approach is that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on niceties of language.

---

55 Sir Kim Lewison *The Interpretation of Contracts* (5th ed, Sweet & Maxwell, London, 2011) at 42.

56 At [62] above.

57 *Antaios Compania Naviera SA v Salen Rederierna AB* [1985] 1 AC 191 (HL) at 201 per Lord Diplock. The other members of the House of Lords concurred with Lord Diplock's judgment.

58 *Mannai Investment Co Ltd v Eagle Star Assurance Co Ltd* [1997] AC 749 (HL) at 770 per Lord Steyn.

59 At 771.

(c) In *Chartbrook Ltd v Persimmon Homes Ltd*, Lord Walker emphasised the need to understand the "general structure" of the parties' bargain when interpreting a commercial contract.[60]

[79] There are some dangers in this approach, as we note when we discuss the parties' commercial absurdity arguments.[61] But despite this, we accept that in interpreting commercial contracts the courts should have regard to their commercial purpose and to the structure of the parties' bargain, to the extent that they can reliably be identified.

[80] Both counsel accepted that insurance contracts allocate risks as between the insured and the insurer. Mr Goddard submitted that in the present case the wording of the policy allocated the risk of underinsurance to the Body Corporate as the insured. Mr Ring accepted that this was the general position under the contract, but said that cl MD15 was an exception because its effect was that Zurich had agreed to accept some of the risk of underinsurance.

[81] Mr Goddard relied on the general structure of the parties' bargain, which he said was clear. The Body Corporate wanted to insure the buildings for their replacement value as estimated by Richard Ellis. In relation to non-natural disaster cover, that is what the Body Corporate did by paying a premium for the 2010/2011 year on the basis of replacement cover of $12.95 million. In doing so, it accepted that it carried the risk of the estimate being too low because $12.95 million became the sum insured and Zurich's maximum liability for non-natural disaster damage to the Body Corporate's buildings. The only way in which the parties' bargain was modified in relation to natural disaster cover was that the EQC would meet the first $6.8 million of a total loss, so that the Body Corporate only needed replacement cover for the difference between the $6.8 million payable by the EQC and the estimated replacement value of $12.95 million, that is, $6.15 million. The premium was calculated accordingly.

---

60 *Chartbrook*, above n 37, at [79] and [95] per Lord Walker.

61 See [88]–[93]below.

[82] We agree with this analysis. We think it clear that ACM sought and Zurich offered natural disaster cover for the difference between the cover provided by the EQC and Zurich's limit of liability under the insurance contract.[62] Viewing the matter objectively, it is difficult to see that Zurich would have offered replacement cover on the buildings for an amount in excess of the replacement estimate provided by the Body Corporate, or that the Body Corporate would have sought such cover, given the replacement estimate's role as the sum insured and limit of liability. It must be remembered in this context that the Body Corporate had an obligation under s 15(1)(b) of the Unit Titles Act to insure for the difference between the EQC cover and the replacement value of the buildings. While it had the power under s 15(1)(c) to take insurance on a more generous basis, it seems to us that the structure of the arrangement in this case was directed at meeting the Body Corporate's s 15(1)(b) obligation.

[83] Accordingly, we consider that, as with non-natural disaster damage, the risk of underinsurance in relation to natural disaster damage lay with the Body Corporate, at least in the context of a total loss.[63]

Specialised meaning

[84] Parties to contracts will sometimes use words that have specialised meanings within a particular profession, industry, trade or locality, or words that have a particular meaning simply to them (the private dictionary principle). It is well established that a court is entitled to receive evidence which demonstrates that the parties have adopted such a specialised meaning.[64]

[85] Mr Goddard noted that ACM sought and received a quote from Zurich for natural disaster "Top Up" cover. There was dispute in the evidence as to whether the term "top up" cover in relation to natural disaster had an accepted meaning in the New Zealand insurance industry, relating to the difference between the maximum cover from EQC and the maximum of the replacement cover with the private insurer.

---

62 *Zurich* (CA), above n 12, at [42].

63 But see n 80 below.

64 See, for example, *Chartbrook*, above n 37, at [45] per Lord Hoffmann; and *Vector*, above n 42, at [25] per Tipping J.

[86] The only evidence to support the view that "top up" cover has an established meaning was the affidavit evidence of Mr Ian Barrett, a former employee of Zurich who was responsible for Zurich's relationship with ACM. He said:

> I have been involved in and around property underwriting since the Earthquake Commission Act 1993 came into force. Standard practice has always been for the Earthquake Commission payments, on earthquake cover, to be included within the building sum insured. If you add together the EQC amount and the company earthquake amount, you arrive at the sum insured for the building.

However, Mr Stuart Thompson, a retired insurance broker who provided affidavit evidence on behalf of ACM, deposed:

> Zurich's witnesses say that there is an industry practice that Clause MD15 is applied so that the Insurer only pays the difference between EQC payments and the Sum Insured. I do not accept that there is any such industry practice. I say this because I am not aware of this clause ever having been considered before. In order for an "industry practice" to have developed, Clause MD15 would have to have been regularly applied in the manner suggested by Zurich in this application, in the insurance market.

[87] Although Mr Thompson's evidence does not really meet Mr Barrett's point, the evidence overall is insufficient to establish that there is a generally accepted meaning for "top up" cover in relation to natural disaster cover in the New Zealand insurance industry, which the parties adopted.[65] It is perhaps a difficulty of the preliminary question procedure that this aspect was not able to be explored in greater detail.

Commercial absurdity

[88] Where contractual language, interpreted in the context of the contract as a whole, has a natural and ordinary meaning, the courts will generally give effect to that as they "do not easily accept that people have made linguistic mistakes, particularly in formal documents".[66] The "primary source for understanding what the parties meant is their language interpreted in accordance with conventional

---

[65] For the sake of completeness, we note that the EQC's current guide for insurers distinguishes between "ground up" natural disaster cover and "top up" natural disaster cover, but not in a way that casts light on the particular point discussed in this section of the judgment: see Earthquake Commission *EQCover: An insurer's guide* (September 2012) at 9.

[66] *Investors Compensation Scheme*, above n 37, at 913 per Lord Hoffmann.

usage".[67] It requires a "strong case" to persuade a court that something must have gone wrong with the language.[68] Professor David McLauchlan, who has been one of the principal academic proponents of a liberal contextual approach to contractual interpretation, nevertheless accepts that:[69]

> … most issues of interpretation that cross a practitioner's desk *can* be advised upon and solved by a reading of the words in the context of the document as a whole. There will usually be no answer to the solution derived from giving the words their 'ordinary' or conventional meaning.

[89] But if consideration of the relevant background forces a court to the conclusion that something has gone wrong with the contractual language, it is not required "to attribute to the parties an intention which they plainly could not have had".[70] Just as the courts have accepted that understanding the commercial purpose of a commercial contract is relevant to its interpretation, so have they accepted that that if a particular interpretation produces a commercially absurd result, that may be a reason to read the contract in a different way than the language might suggest.[71] However, it has also been accepted that a court is not justified in concluding that a contract does not mean what it seems to say simply because the court considers that, so interpreted, the contract is unduly favourable to one party.[72] There is an obvious tension between these two positions, and it will often be difficult to determine whether particular cases fall within one category or the other.[73]

[90] Moreover, there is reason to be cautious in this area because commercial absurdity tends to lie in the eye of the beholder. As Lord Hoffmann observed in *Chartbrook*:[74]

> It is, I am afraid, not unusual that an interpretation which does not strike one person as sufficiently irrational to justify a conclusion that there has been a linguistic mistake will seem commercially absurd to another[.]

---

67 *Bank of Credit and Commerce*, above n 40, at [39] per Lord Hoffmann.

68 *Chartbrook*, above n 37, at [15] per Lord Hoffmann.

69 David McLauchlan "Contract Interpretation: What Is It About?" (2009) 31 Sydney L Rev 5 at 11 (original emphasis).

70 *Investors Compensation Scheme*, above n 37, at 913 per Lord Hoffmann; and see *Chartbrook*, above n 37, at [14] per Lord Hoffmann.

71 As occurred, for example, in *Investors Compensation Scheme*, above n 37, and *Chartbrook*, above n 37. See also *Vector*, above n 42, at [8]–[10] per Blanchard J.

72 *Chartbrook*, above n 37, at [20] per Lord Hoffmann.

73 See the discussion in David McLauchlan "Contract Interpretation in the Supreme Court – Easy Case, Hard Law?" (2010) NZBLQ 229 at 236–238.

74 *Chartbrook*, above n 37, at [15] per Lord Hoffmann.

Assessments of commercial purpose or commercially absurd consequences will be influenced by factors such as the background and experience of the court. In *Skanska Rashleigh Weatherfoil Ltd v Somerfield Stores Ltd*, Neuberger LJ, although acknowledging the importance of a contextual approach to contractual interpretation, noted that the parties have control of the language of negotiated commercial contracts and went on to say:[75]

> [22] Particularly in these circumstances, it seems to me that the court must be careful before departing from the natural meaning of the provision in the contract merely because it may conflict with its notions of commercial common sense of what the parties may must or should have thought or intended. Judges are not always the most commercially-minded, let alone the most commercially experienced, of people, and should, I think, avoid arrogating to themselves overconfidently the role of arbiter of commercial reasonableness or likelihood. …

[91] In addition, those who negotiate commercial contracts will be influenced by a range of considerations in reaching their final bargains. The contracts that emerge from the process of negotiation will reflect accommodations of the parties' varying interests, as they assess them at the time. The reasons underlying the compromises that typically occur in commercial negotiations may not be easily perceived or understood by a court, even if they are exposed as part of the relevant background.

[92] Despite his expression of caution in *Skanska*, Neuberger LJ did accept that commercial common sense still had a role to play:[76]

> Of course, in many cases, the commercial common sense of a particular interpretation, either because of the peculiar circumstances of the case or because of more general considerations, is clear. Furthermore, sometimes it is plainly justified to depart from the primary meaning of words and give them what might, on the face of it, appear to be a strained meaning, for instance where the primary meaning of the words leads to a plainly ridiculous or unreasonable result.

[93] All this means that where contractual language, viewed in the context of the whole contract, has an ordinary and natural meaning, a conclusion that it produces a

---

75 *Skanska Rashleigh Weatherfoil Ltd v Somerfield Stores Ltd* [2006] EWCA Civ 1732 per Neuberger LJ. Richards and Leveson LJJ agreed with Neuberger LJ's judgment.

76 At [22].

commercially absurd result should be reached only in the most obvious and extreme of cases.[77]

[94] Both counsel referred to various anomalies or absurdities that would occur if the Court were to accept the interpretation of cl MD15 advanced by the other. In general, however, these do not result from particular interpretations but from the fact of underinsurance. If the reinstatement estimate that formed the basis of the sum insured had been accurate, most of the anomalies or absurdities referred to would not arise.

[95] For example, Mr Ring submitted that if the Court of Appeal's interpretation was correct:[78]

> Zurich's liability would be greater if there was only a partial loss caused by earthquake than if there was a total loss. For example, based on the current figures and applying the Court of Appeal's interpretation, if only one of the Body Corporate's buildings had been destroyed, Zurich would have to pay $9.1m;[79] but, if both buildings are destroyed, its maximum liability is said to be only $6.15m. This is the very definition of "*commercial absurdity*", in terms of [*Vector*]. It also completely undermines the "*commercial context*" and presumed mutual intent factors, heavily relied on by Zurich, and endorsed by the Court of Appeal, as leading to the conclusion that Zurich's maximum liability for earthquake damage was only $6.15m because this was the amount on which its earthquake premium had been calculated.

But this result does not flow from the interpretation accepted by the Court of Appeal but rather from the fact that the apartment complex was underinsured. If the buildings had been insured to their true reinstatement value, the "commercial absurdity" identified would not arise.[80]

---

[77] See Lord Grabiner "The Iterative Process of Contractual Interpretation" (2012) 128 LQR 41 at 50.

[78] (Original emphasis and footnote).

[79] $25m x 50% = $12.5m, minus $3.4m (34 dwellings x $100,000).

[80] We express no view on the approach to be taken if only one building had suffered damage and that damage was within the limit of the sum insured.

[96] Mr Goddard sought to demonstrate the absurdity of ACM's interpretation by contrasting the outcome if the buildings were destroyed by fire arising from a nonnatural disaster with that which would follow a fire resulting from a natural disaster.[81] Mr Goddard submitted that, on ACM's interpretation, in the first situation, the Body Corporate's maximum recovery would be the sum insured, $12.95 million, but in the second it would be $12.95 million plus the EQC's $6.8 million, a total of $19.75 million. He argued that it was absurd to think that the parties intended such an outcome. The Body Corporate would be indifferent to the precise cause of loss. What it wanted was cover to the full amount of its potential loss, however that occurred. The replacement value identified the expected extent of a total loss.

[97] To some extent, this is the "structure of the bargain" argument in another guise, although the focus is rather different. But considering the outcome in terms of commercial absurdity illustrates the difficulty with this type of argument. Zurich did provide several covers for which it did not charge a separately identifiable premium. It is conceivable that an insurance company, for marketing or similar reasons, might offer additional cover at no extra charge in circumstances where it thought it unlikely that the cover would ever be called upon. It might, for example, agree to share the risk of underinsurance. The contractual language and the structure of the parties' bargain persuade us that this was not what was intended here. But it is difficult to say that such an outcome would be commercially absurd.

A final point

[98] As we noted above, in accepting the interpretation of the contract contended for by ACM, the High Court placed some weight on the result that they considered would occur under s 30(1).[82] As with some of the commercial absurdity arguments raised, however, the anomalous outcome identified by the High Court results from the fact of underinsurance rather than from the statutory provisions themselves. Moreover, the parties entered into contractual arrangements that were intended to bring s 30(2) into play, not s 30(1). Accordingly, we do not see that the position that

---

[81] It will be recalled that "natural disaster" is defined in the EQC Act to include fire resulting from natural disaster: see [52] above.

[82] See at [44] above.

may have applied under s 30(1) assists, especially as s 30(1) is not a straightforward provision and has, in any event, very limited practical application.

Decision

[99] We would dismiss the appeal, with the consequences identified at [16] above.

Solicitors:
Jones Fee, Auckland for Appellant
DAC Beachcroft New Zealand, Auckland for First Respondent
Morgan Coakle, Auckland for Second Respondent