IN THE SUPREME COURT OF NEW ZEALAND

SC 41/2014
[2014] NZSC 185

	BETWEEN	TOWER INSURANCE LIMITED Appellant
	AND	SKYWARD AVIATION 2008 LIMITED Respondent

Hearing:	5 November 2014
Court:	McGrath, William Young, Glazebrook, Arnold and O'Regan JJ
Counsel:	R B Stewart QC and M C Smith for Appellant N R Campbell QC and K P Sullivan for Respondent
Judgment:	15 December 2014

JUDGMENT OF THE COURT

A The appeal is dismissed. We answer the questions posed as follows:

(a) Under the terms of the insurance policy, on what basis is the amount payable by Tower to be calculated if [an insured party's] claim is to be settled by Tower paying the cost of buying another house?

Answer

Tower's liability is the lower of the cost of rebuilding the insured house at its present site or the cost of the other house. There is no requirement that the other house be "comparable" to the insured house.

(b) Under the terms of the insurance policy, is it Tower's choice:

(i) whether the claim is to be settled by paying the cost of buying another house?

Answer

No.

(ii) if settlement by Tower making payment is chosen, whether the payment is to be made based on the cost of rebuilding the insured house, replacing the insured house or repairing the insured house?

Answer

If Skyward buys another house, Tower must pay the lesser of the cost of the house or the cost of rebuilding the insured house on its present site.

B We allow the cross-appeal. Tower is to pay Skyward costs and disbursements in respect of the High Court proceedings to be fixed by that Court.

C In respect of the appeal and cross-appeal, Tower is to pay Skyward costs of $25,000 and reasonable disbursements to be fixed by the Registrar.

REASONS

(Given by William Young J)

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The appeal

[1] Skyward Aviation 2008 Ltd's residential property at 108 Kingsford Street, Burwood, Christchurch was affected by earthquakes on 4 September 2010 and 22 February and 13 June 2011. The property is within the residential red zone which was established in June 2011. Land and infrastructure in this zone have suffered such extensive damage that rebuilding and repair are not practicable in the short to medium term. The Crown, through the Canterbury Earthquake Recovery Authority (CERA), has acquired most of the insured red-zoned residential land pursuant to purchase offers based on the 2007 rating valuations. One of the options available to land owners was to sell their properties at the land value recorded in the rating valuations but to retain the right to pursue their insurers for physical damage to improvements. Skyward accepted this option. So it has sold the property for its 2007 rating land value and has claimed for physical damage to the improvements (principally a house and a sleep out) against the Earthquake Commission (EQC) and its insurer, Tower Insurance Ltd.

[2] Skyward has since settled its claims against EQC. It has also settled with Tower in relation to the sleep out. There is, however, an unresolved dispute as to the house. Tower's position is that it has the right to choose from a variety of payment settlement options under the insurance policy and that it is entitled to discharge its obligations by doing no more than paying the cost of another – and not necessarily new – house elsewhere. In the High Court,[1] David Gendall J found in favour of Tower but his decision was reversed by the Court of Appeal.[2]

[3] Principally in issue before us is Tower's appeal against the Court of Appeal judgment. There is, however, also a cross-appeal by Skyward. The Court of Appeal, despite allowing Skyward's appeal, did not award it the costs of the High Court proceedings.[3] Skyward maintains that, having succeeded in the litigation, it ought to have been awarded costs in the High Court.

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1 *Skyward Aviation 2008 Ltd v Tower Insurance Ltd* [2013] NZHC 1856 [*Skyward* (HC)].
2 *Skyward Aviation 2008 Ltd v Tower Insurance Ltd* [2014] NZCA 76, [2014] 2 NZLR 713 (Randerson, Harrison and Miller JJ) [*Skyward* (CA)].
3 At [54].

Some more context

[4] The issue that we must resolve depends entirely on the construction of the insurance policy. But some further context may be of some assistance.

[5] Skyward purchased the property in 2009 for $450,000. Under the 2007 rating valuation, the property was valued at $582,000, divided equally between $291,000 for the land and $291,000 for improvements. The value of the property (including all improvements) immediately before the earthquakes has been assessed at $492,000.[4] Both house and sleep out were rented to residential tenants. The house was insured under Tower's "Provider House (Maxi Protection) Policy" and the renewal certificate provided:

> SUM INSURED FULL REPLACEMENT based on Area Sq Metres 210. Year Built 1900.

The sleep out had been built, as a garage, in 1989 and had been converted into a sleep out in late 2009 and early 2010. It was separately insured for full replacement value based on an area of 50m^2. We infer that Skyward incurred some expenditure in respect of the garage/sleep out conversion.

[6] Skyward gave Tower notice of its intention to accept CERA's offer of $291,000 for the land. Tower did not object. Although it is not now suggested that the house should be repaired or rebuilt on the existing site, the notional costs of a rebuild operate as a cap on Tower's liability under the policy.

[7] Skyward has so far received a total of approximately $788,000, being: (a) $291,000 from CERA for the sale of the land; (b) $203,000 from EQC for house damage; (c) $128,000 from EQC and Tower in relation to the sleep out and other improvements; and (d) $166,000 from Tower for house damage. This last payment was made on a without prejudice basis.

[8] Skyward says the house could be repaired (or rebuilt) on the site at a cost of $683,000. Tower's corresponding estimate is $369,000. As we will see, if this latter estimate is right, the payments which Skyward has already received in respect of the

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[4] By a valuer retained by Tower.

house ($203,000 from EQC and $166,000 from Tower) are sufficient to discharge Tower of any further liability under the policy. The litigation to date, however, has not focused on repair or rebuild costs. This is because Tower claims that its liability can be capped at a slightly lower figure.

[9] As we will see, one of the settlement options under the policy is for Skyward to buy another house and for Tower to pay the costs of doing so up to what it would cost to rebuild the insured house on its present site. On Skyward's case, it is thus entitled to buy another house and to be reimbursed for the cost up to $683,000. If its arguments and figures are correct, it is therefore entitled to be paid the difference between $683,000 and the $369,000 it has already been paid, around $314,000.

[10] Tower maintains that the house to be acquired must be comparable to the insured house. As well, its position is that such a house need not be new. Tower contends that Skyward is entitled to no more than the cost of buying such a comparable house. It claimed that the cost of doing so would be only $365,000. If Tower's argument and figures are correct, then, on the basis of the arithmetic set out above, the payments which Skyward has received are sufficient to discharge Tower's obligations under the policy. We note in passing that that the $365,000 assessment is on the light side as it is based on a valuation of what Tower said was a like house being "a 100 year old second hand house only in average condition".[5] Tower now accepts that, if not new, the replacement house must nonetheless be comparable to the insured house "as when new" and so will have been recently renovated and have no significant deferred maintenance.

[11] More generally, Tower protests that settlement on Skyward's measure would be contrary to settled principles of indemnity because the company would recover around $1,100,000 in respect of a property which it bought in September 2009 for $450,000 and which had a pre-earthquakes market value which has been assessed at

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5 See David Gendall J's costs decision: *Skyward Aviation 2008 Ltd v Tower Insurance Ltd* [2013] NZHC 2452 at [16] [*Skyward* (costs)].

$492,000 (which presumably allows for the added value associated with the costs incurred by Skyward converting the garage into a sleep out).[6]

The insurance policy

[12] The policy is in plain-English style and its provisions are not numbered. This makes for some difficulty in terms of analysis and description. For ease of future discussion, we therefore reproduce the relevant wording in the right column of the table below with, in the left column, clause numbers we have allocated to the different components of that wording. As will become apparent, what we have labelled cl 2 is critical to the case. That clause provides for four settlement options which we identify as options (a) to (d).

Allocated clause number	**Wording**
Clause 1	HOW WE WILL SETTLE YOUR CLAIM We will arrange for the repair, replacement or payment for the loss, once your claim has been accepted.
Clause 2	**We will pay**:
option (a):	the **full replacement value** of **your house** at the **situation**; or
option (b):	**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
option (c):	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
option (d):	the **present day value**;
	as shown in the **certificate of insurance**.

[6] Indemnity is a core principle of insurance law: see *Castellain v Preston* (1883) 11 QBD 380 (CA) at 386 per Brett LJ; and *Ridgecrest NZ Ltd v IAG New Zealand Ltd* [2014] NZSC 129 at [19] n 6.

	We will only allow **you** to rebuild on another site or buy a house if **your house** is damaged beyond economic repair.
Clause 3	**In all cases:** … we have the option whether to make payment, rebuild, replace or repair your house; … **we** will not pay more than the sums insured shown in the certificate of insurance unless **you** have **full replacement value** then there is no limit to the sum insured;
Clause 4	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.

[13] The words in bold are all defined in the policy. Only two of the definitions are sufficiently material to warrant setting out in full:

> ***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.
>
> ***Present day value*** means the cost at the time of the loss or damage of rebuilding, replacing or repairing your house to a condition no better than new and up to the same area as shown in the certificate of insurance, plus any decks, undeveloped basements, carports and detached domestic outbuildings, less an appropriate allowance for depreciation and deferred maintenance, but limited to the market value of the property less the value of the land as an unoccupied site.

We note as well that the definition of "your house" includes improvements, such as decks and swimming pools.

[14] It is common ground that, for the purposes of cls 1, 2 and 3, Tower has elected to "make payment" (see cl 3).[7] This means that the case falls to be determined under cl 2. It will be noted that options (a), (b) and (c) all provide for recovery which is referable, in one way or another, to the "full replacement value" of the house. In later discussion we will refer to them as providing for replacement value recovery. In contradistinction, option (d) is based on what is normally referred to as indemnity value.

[15] We note in passing that the assumption of the parties is that under option (c), "the cost of buying another house" refers not to the price paid by the insured for the land and house but rather only that portion of the price which is referable to the house. We have not been asked to determine whether this assumption is correct.[8]

The questions that we are required to resolve

[16] In an attempt to resolve their differences the parties agreed to submit three questions to the High Court for determination, two of which remain in contention. They are:

(a) Under the terms of the insurance policy, on what basis is the amount payable by Tower to be calculated if [an insured party's] claim is to be settled by Tower paying the cost of buying another house?

(b) Under the terms of the insurance policy, is it Tower's choice:

(i) whether the claim is to be settled by paying the cost of buying another house?

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7 Throughout these reasons, we will use the language of cl 3 ("make payment") rather than the corresponding but clumsier words in cl 1 ("arrange for … payment").

8 The basis of the assumption is that since Tower did not insure the land but only the house, it is logical to treat its replacement value payment obligation as triggered only to the extent that the insured's payment is referable to the house. In practical terms this would require a valuation apportioning the price paid by the insured for the replacement property as between land and buildings.

(ii) if settlement by Tower making payment is chosen, whether the payment is to be made based on the cost of rebuilding the insured house, replacing the insured house or repairing the insured house?

These questions focus on the operation of option (c) in cl 2. The premise of the questions is that there has been a cl 3 election by Tower to "make payment" rather than for Tower to itself "rebuild, replace or repair" the house.

[17] As noted, these questions were answered in Tower's favour by David Gendall J but in Skyward's favour by the Court of Appeal.

Tower's interpretation

[18] Tower's argument is as follows:

(a) In cls 1 and 3, "replacement" and "replace" encompass options (b) and (c) in cl 2. This is on the basis that payment by Tower of "the full replacement value of your house on another site you choose" (option (b)), and "the cost of buying another house" (option (c)) would amount to "replacement" by Tower of the house. Tower also contends that if the insured rebuilds the house and seeks and receives reimbursement under option (a), Tower has, in this way, "rebuilt" the house.

(b) If Tower elects under cl 3 to make a payment, it may also choose between options (a), (b) and (c). Accordingly, even where Tower has elected not to repair, rebuild or replace the house, it may determine what the insured must do as a prerequisite to obtaining replacement value recovery under those options.

(c) If Tower decides that it will only "replace" the house by meeting the cost of buying another house, it may invoke cl 4 so as to insist on the house which is purchased being "reasonable, practical or comparable with the original".

(d) Tower's maximum liability under option (c) is the lower of the cost of the cheapest comparable and not necessarily new "replacement" house and the cost of rebuilding the insured house at its situation. As to this Tower accepts that it must act reasonably and in good faith. And, as already noted, it also now accepts that the "replacement house", if not new, should be recently renovated and have no significant deferred maintenance.

In their written submissions, counsel for Tower also argued that Skyward could not invoke option (c) if it paid more for the other house than the cost of rebuilding the insured house. In other words, on the assumption of a rebuilding cost of $400,000, a purchase by Skyward of another house for, say, $500,000 would not entitle it to reimbursement of $400,000 towards the cost. During the hearing, this argument was abandoned.

The High Court judgment

[19] In the High Court David Gendall J accepted that "replace" and "replacement" encompassed the first three payment options provided for in cl 2 and that therefore, under cl 3, Tower had the right to choose the basis of settlement. In doing so, he followed the judgment of Asher J in *O'Loughlin v Tower Insurance Ltd*, which related to the same insurance policy.[9] It is right to say, however, that when he analysed the cash settlement options under cl 2,[10] he did so in a way which assumed that it was for Skyward to decide which of options (a), (b) or (c) should be invoked. There is thus a disconnect between his analysis and ultimate conclusion. For this reason, his judgment on this aspect of the case is best regarded as an adoption of the following passage from the judgment of Asher J in *O'Loughlin*:

> [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.

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9 *O'Loughlin v Tower Insurance Ltd* [2013] NZHC 670, [2013] 3 NZLR 275.

10 *Skyward* (HC), above n 1, at [42](b).

> [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. …
>
> [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":
>
> > 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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> [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.
>
> …
>
> [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.

[20] David Gendall J also accepted that cl 4 applied not only to establishing the extent of the rebuild cost (and thus the cap on Tower's liability) but also to the kind of house that Skyward could buy:

> [46] How then is the amount of the payment which Tower must make to be calculated in terms of the policy if Skyward's claim here is to be settled by Tower paying the cost of buying another house? The answer to this question, as I have noted above, is simply that Tower's obligation under this replacement option is the same in principle as that for a repair or rebuild and requires:
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> (a) As a fundamental starting point, a proper consideration of the size, construction, condition, style and extent of the house as when new on a sound site; and
>
> (b) An obligation on Tower to indemnify Skyward for actual costs incurred to replace the house to this condition, to the extent replacement in such a manner is reasonable, practical and comparable with the original; and
>
> (c) The obligation on Tower is subject to the proviso that it is not obliged to pay more than the notional cost of rebuilding the house on its existing Kingsford Street site.

…

> [58] … [T]he amount to be payable by Tower, where it is to pay to Skyward the cost of buying another house, is to be the fair price of a replacement house which is to a reasonable and practical extent comparable, of the same 207 m^2 size and construction (as far as may be possible), in the same condition, and of the same style and extent (more or less), as the Kingsford Street house was when new. This could be a new or (more likely) a second hand house sited outside the red zone. As to whether its size, construction and quality were reasonably comparable, these would all be determined on the facts of this particular case. …

[21] He went into some considerable detail as to the sort of house which Tower might insist on:

> [53] By way of example, a … comparable replacement house in this case might comprise the following features:
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> - An approximately 207m^2 replica early 1900s villa home on sound foundations, with verandahs;
> - Exterior construction of weatherboard and wooden joinery in a similar style with an iron roof;
> - High interior roof stud;
> - Exposed solid timber floors (possibly tongue and groove construction) if appropriate;
> - Plasterboard walls and (possibly decorative) plaster ceilings;
> - Fireplaces or fireplace facades (if appropriate);
> - Timber interior joinery, doors, skirting boards and architraves;
> - Reasonably quality replica-type internal fittings.

[22] On the approach contended for by Tower and accepted by the Judge, it is open to Tower:

(a) to pay rather than to itself repair or replace the house; and

(b) even if Skyward wishes to rebuild on site or build a replacement house somewhere else, to pay no more than "present day value" unless and until Skyward has purchased an existing house which must closely resemble the insured house and will not necessarily be new,

although Tower now accepts that it must be comparable to the insured house "as when new".

The approach of the Court of Appeal on the interpretation issue

[23] The interpretation favoured by the Court of Appeal and the reasons for it are sufficiently similar to the approach which we propose to take as to render a review of that Court's judgment unnecessary.

Our approach

The general context

[24] The insurance policy is for full replacement value and proceeds on the basis of replacement on a new for old basis. The availability of such policies reflects a recognition that a traditional indemnity value policy may not provide sufficient funds to enable a damaged building to be repaired or rebuilt given that such exercises will require new materials and compliance with current building standards which may be more stringent than those in place when the building was constructed. A replacement value policy thus covers the impact of depreciation[11] and increased building costs. Arising out of this are two considerations.

[25] The first is that it is not surprising that the cost of rebuilding a house that was approximately 110 years old considerably exceed the indemnity value of the house immediately before the earthquakes. For that reason, there is little resonance in Mr Stewart QC's appeal to the indemnity principle. As this Court has recently observed, "the indemnity principle" is "a slightly awkward phrase in the context of a replacement policy".[12]

[26] Secondly, the figures that we have provided as to Skyward's receipts to date and further claims as against what it paid for the property and the property's value in

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11 *Brkich & Brkich Enterprises Ltd v American Home Assurance Co Ltd* (1995) 127 DLR (4th) 115 (BCCA) at [29].

12 *Ridgecrest NZ Ltd v IAG New Zealand Ltd*, above n 6, at [54]. As that case illustrates, the applicability of the indemnity principle is subject to the wording of the policy under consideration. See also Neil Campbell and Barnaby Stewart "Prevention of Performance in Replacement Cost Insurance – Preventing a Fictional Response" (2002) 10 Otago L Rev 229 at 231.

September 2010 are of interest because they illustrate how replacement value insurance creates heightened moral hazard.[13] The associated risks can be mitigated by insurers in various ways, including by policies (a) providing insurers with the option of reinstating the property, and (b) limiting replacement value recovery to reimbursement of expenditure incurred by the insured.[14] In the latter case, it is open to an insurer to require actual reinstatement or replacement by the insured, on a new for old but otherwise like for like basis, as a precondition for paying out anything above indemnity value. It will be noted that options (a) and (b) in cl 2 of the policy proceed on this basis. A review of the cases and literature shows that conditions of this sort are commonplace in replacement value insurance policies.[15]

[27] Strict pre-conditions on the ability of an insured to achieve replacement value recovery limit the incentive for fraudulent claims but may also be irksome for an honest insured who, for instance, may not wish to replicate what has been lost. Policies which provide more flexible criteria will therefore be more palatable to the market.[16] It is presumably for this reason that option (c) in cl 2 is expressed in terms which are not predicated on the new house being a like for like replacement for the insured house. In this context, this third option might be thought to be primarily for the benefit of Skyward, so as to make it easier rather than harder to obtain replacement value for its loss.

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13 There is increased moral hazard because an insured may obtain more than mere indemnity for the damaged property and thus profit from the loss. The incentive for carelessness and fraudulent claims is thus greater than in the case of an indemnity value policy. See Campbell and Stewart, above n 12, at 231–232; Malcolm A Clarke *The Law of Insurance Contracts* (6th ed, Lloyds of London Press, London, 2009) at [28.3C]; *Brkich & Brkich Enterprises Ltd v American Home Assurance Co Ltd*, above n 11, at [29]; and Leo John Jordan "What Price Rebuilding?" (1990) 19 ABA Brief 17 at 18–20.

14 *Brkich & Brkich Enterprises Ltd v American Home Assurance Co Ltd*, above n 11, at [29]; and Jordan, above n 13, at 19.

15 See *Brkich & Brkich Enterprises Ltd v American Home Assurance Co Ltd*, above n 11 at [25]; *Ridgecrest NZ Ltd v IAG New Zealand Ltd*, above n 6, at [8]; *McLean v IAG New Zealand Ltd* [2013] NZHC 1105 at [3]; *TJK (NZ) Ltd v Mitsui Sumitomo Insurance Co Ltd* [2013] NZHC 298, (2013) 17 ANZ Insurance Cases 61–968 at [27]; Campbell and Stewart, above n 12, at 229; and Jordan, above n 13, at 19–20.

16 Such as allowing the insured to rebuild in a way that differs from the original, to rebuild on a new site or to purchase another building altogether. A number of recent New Zealand decisions involved policies with flexible criteria: see *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd* [2012] NZHC 3344, (2012) 17 ANZ Insurance Cases 61-965 at [4]; *Ridgecrest NZ Ltd v IAG New Zealand Ltd*, above n 6, at [8]; *McLean v IAG New Zealand Ltd*, above n 15, at [3]; and *TJK (NZ) Ltd v Mitsui Sumitomo Insurance Co Ltd*, above n 15, at [26].

[28] In writing replacement value policies, Tower has been content to manage the associated moral hazard using the mechanisms which we have discussed. These come down to its entitlement to reinstate the house or, where it is not prepared to do so, to pay no more than indemnity value except by way of reimbursement for expenditure actually incurred. Once Tower has opted to make payment, its obligations are solely monetary in character and, providing the insured actually incurs the expenditure for which it is entitled to reimbursement, Tower should be indifferent to the mechanism by which Skyward triggers its right to replacement value recovery.[17]

[29] Tower's argument in the High Court was that its liability is limited to the cost of buying a comparable house with the example it chose being 100 years old and in only average condition. This suggested, as Skyward's counsel argued, that Tower was claiming to have the option of paying out on the basis of indemnity value. David Gendall J did not accept Tower's argument in full as he plainly did not accept Tower's exemplar house as comparable. As is apparent from what we have already said, Tower's position has shifted as it accepts that the "replacement" house, if not new, must have been recently renovated and have no significant deferred maintenance.

[30] It remains the case, however, that the position adopted by Tower would compromise the ability of Skyward to obtain replacement value recovery on the new for old basis contemplated by the policy. We see such a result as inconsistent with the purposes of:

(a) the scheme of options (a), (b) and (c), which we see as addressed to moral hazard rather than intended to enable Tower to convert what was sold as a replacement value policy into something akin to an indemnity value policy; and

(b) option (c), in particular, which is to enhance, rather than diminish, the ability of an insured to obtain replacement value recovery.

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[17] See *Skyward* (CA), above n 2, at [23], [27] and [29] where a similar point is made.

Difficulties with the wording of the policy

[31] There are a number of infelicities in the wording of the policy. Of these, the most material is the inconsistent use of the words "repair", "replacement" and "replace" and "rebuild". In cl 1, the words "repair" and "replacement" are used. What must be the same subject matter is referred to in cl 3 as "rebuild, replace or repair". Under cl 4, Tower is not required to pay more than present day value, "until the cost of replacement or repair is actually incurred". Then, in the next sentence, the policy provides for payment of present day value if the insured chooses not to "rebuild or repair" the house or "buy another house". A little later in the same clause, the words "repair or reinstate" appear, one of which – "reinstate" – is not otherwise used in the policy.

[32] Despite this and other difficulties, we consider that the overall meaning of the policy wording is clear. We note, however, that if it were otherwise, the policy, as Tower's document, falls to be interpreted on a contra proferentem basis.

Does "replace" in cl 3 encompass the buying of another house?

[33] Tower's position is that if the insured repairs or rebuilds the house on the site, replaces it on another site or buys another "replacement house", and is later reimbursed by Tower for the associated costs, Tower has thereby rebuilt, replaced or repaired the house for the purposes of cl 3. On this basis, Mr Stewart maintains that cl 3 confers on Tower the choice of deciding between which of options (a), (b) and (c) is to be adopted.

[34] In favour of Mr Stewart's approach on this point are two considerations:

(a) As a matter of plain English, another house which is bought pursuant to cl 2 is, in a sense, a "replacement" for the insured house.

(b) It could be said, albeit not particularly accurately, that where Tower reimburses the insured for the already incurred cost of buying such a house, it has, in that way, replaced the house.

We see these factors as outweighed by the considerations to which we now turn.

[35] Tower's approach is not consistent with the wording of cl 3. If Tower declines to rebuild, replace or repair the insured house and the insured then does so, it is the insured who has replaced the house and not Tower. And when Tower reimburses the expenditure incurred by the insured, this is by way of discharge of its obligation "to make payment". As well, the language of cl 3 confers on Tower a single option, to decide either to make payment or to rebuild, replace or repair. There is nothing in the language of the clause to suggest that Tower has the double option, first to determine whether "to make payment, rebuild, replace or repair" and, then, if it has chosen to "make payment", the further ability to decide which of the cl 2 payment options is adopted.

[36] Tower's argument is also not consistent with the language of cl 2:

(a) Unless the house is damaged beyond economic repair, the only options available are option (a) – replacement value of the house at its situation – and option (d) – present day value. In this situation the choice is for the insured. Where the house is damaged beyond economic repair, the insured may choose present day value by deciding not to take any of the steps that engage options (a), (b) and (c). In these situations, it is perfectly clear that the option which applies is decided by the insured. Tower does not dispute this and says that its right to choose applies only after an insured has decided against present day value.

(b) If the house is damaged beyond economic repair, all four options are available. Again, present day value is the default, in this instance, unless the house is rebuilt or repaired on site, or replaced on another site, or another house is bought. As to these options, cl 4 proceeds expressly on the basis that it is the insured who chooses.

(c) That option (b) – replacement of the house on another site – involves a choice on the part of the insured is confirmed by the policy wording which makes it clear that such site must be chosen by the insured.

(d) The language of the proviso to cl 2 – "only allow you to rebuild on another site or buy a house" – is inconsistent with Tower deciding whether to rebuild on another site or buy a house. Indeed, the proviso is completely surplus to requirements on Tower's approach because, on that approach, the insured could never exercise options (b) and (c) without Tower's consent.

[37] There are other more general considerations which point in the same direction:

(a) Tower's approach goes beyond what is necessary to address moral hazard concerns, given (i) Tower's option of arranging for the rebuilding, replacement or repair of the house; and (ii) the restrictions in cl 2 which mean that the insured can only obtain replacement value recovery as reimbursement for expenditure actually incurred.

(b) More generally still, Tower's interpretation would result in an insured's entitlements being distinctly less than what the policy appears to envisage. Thus in the case of a house which is a total loss, the most obvious settlement mechanisms are (a) for Tower to rebuild the house on the site; or (b) if Tower chooses "to make payment", for the insured to rebuild the house on the site and then be reimbursed. The premiums were presumably set accordingly and on this basis Tower has no ground for complaint if it is required to pay out the costs of such an exercise. But on Tower's interpretation it can, by withholding payment of anything more than present day value, force the insured instead to buy the cheapest non-new house which is comparable to the insured house and in this way achieve 'replacement' for a cost that may be appreciably less than the replacement value of the house. As well, it is implicit in Tower's

argument that it either chooses the replacement house or has a practical right of veto (subject of course to review by courts) of any house which the insured would like to buy.

(c) Tower's approach would give it the right (subject only to arguments about reasonableness) to insist on the replacement house being in another suburb or even city, despite close connections (for instance as to schooling) that the insured might have with the locality in which the insured house is situated.

[38] For those reasons, we are satisfied that in a case where a house is damaged beyond economic repair and where Tower has decided not to rebuild or replace the house, Tower's payment obligations under cl 2 are determined by the choice which the insured makes as to whether to rebuild the house or replace it on another site or buy another house.

Does the cl 4 limitation as to "what is reasonable, practicable or comparable with the original" apply to the other house which is acquired?

[39] If Tower assumes responsibility for repairing or rebuilding the house, cl 4 provides that it is not required to "repair or reinstate [the house] exactly to its previous condition". As well, Tower is not required to "pay the cost of replacement or repair beyond what is reasonable, practical or comparable with the original". Although the exemption is expressed to be in relation to Tower's payment obligations, we are inclined to see it as also applying where Tower has directly engaged in replacement or repair. In any event, in the present context, the exemption is plainly intended to apply to the calculation of "replacement value" for the purpose of options (a) and (b) and the rebuilding costs for the purpose of options (b) and (c).

[40] This means that in the context of option (c) (buying another house), the exemption applies in relation to the fixing of Tower's maximum liability (that is, by reference to the cost of rebuilding the house at its situation). On Tower's argument, it also has a separate and entirely distinct application as to the type of house which is to be acquired. On Tower's approach, its liability to pay under option (c) is not triggered by the purchase of a house unless it is comparable to the insured house.

The practical difficulties with this approach are highlighted in the passage from David Gendall J's judgment which we have cited.[18] It may not be easy to find an existing house which meets the "as when new" criterion specified in the definition of "full replacement value" but which is also comparable to a villa built in 1900. In this case, the parties have settled in relation to the sleep out. But if they had not settled, the comparable house envisaged by David Gendall J would presumably also have been required to have a comparable sleep out. The associated difficulties are increased if there needs to be allowance for other improvements, such as decks, garages and swimming pools.[19]

[41] The practical implications for Skyward (and indeed any insured) of such an approach are obvious. It may be that a house which is comparable to the insured house may not exist. If this is so, Skyward can be denied replacement value recovery during a vain search for such a comparable house. As well, given the impressionistic nature of the envisaged exercise, there would be scope for much debate as to whether a house identified by Skyward did in fact satisfy the test. Such debate could no doubt ultimately be resolved by the courts but this would be a time consuming process which might not be able to be concluded before the house in question was sold to someone else.

[42] As will be apparent, the comparable house approach of Tower as first advanced – by reference to a 100 year old house in only average condition – would produce an outcome that would be consistent more with an indemnity than a replacement value policy. And although Tower's argument to us was not so extreme, its tendency is still to diminish its primary full replacement value obligation. As well, as with the argument just addressed, the argument relies on option (c) as limiting rather than enhancing what would otherwise be the entitlement of Skyward to recover replacement value.

[43] These practical and policy considerations strongly point away from Tower's interpretation. But, in any event, there is no indication in cl 4 that the exemption

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18 See above at [20]–[21].

19 "House" is defined in the policy as including such items as gates, fences, permanent swimming pools and spa pools "and any other domestic structures on the same site (other than metal driveways or paths)".

applies twice, both as a limit to the liability cap and as a constraint on the type of house that the insured may acquire, so as to trigger a right to payment under cl 2.

[44] In short, we are of the view that if the insured chooses to buy another house, the only cap on the cost that Tower must meet is that it will not exceed the cost of rebuilding the insured house at its present site and there is no requirement that the house which is bought be "comparable" to the insured house.

The costs cross-appeal

[45] In the High Court, David Gendall J held that costs should lie where they fell.[20] This was principally because the litigation was seen as being something of a test case with significant effects in relation to a number of other insurance claims faced by Tower.[21] It also, to perhaps a more limited extent, was a consequence of Skyward achieving a measure of success in respect of the comparability of the house relied on by Tower.[22]

[46] The Court of Appeal dealt with costs in this way:[23]

> In the High Court David Gendall J declined to make an award of costs in Tower's favour. He was satisfied that costs should lie where they fall. Tower appeals. The arguments advanced by Tower in challenge to that decision proceeded on the premise that it would succeed in this Court. The result of Skyward's success would normally mean that it would be entitled to costs in the High Court. However, the same principles on which it successfully relied in the High Court still prevail. An additional factor is that considerable argument was devoted in the High Court to Skyward's identification and pursuit of question 3. The costs appeal is dismissed.

The reference to "question 3" was to an argument upon which Skyward was unsuccessful in the High Court and Court of Appeal and which was not advanced before us.

[47] Skyward has cross-appealed against the refusal of the Court of Appeal to direct that it recover costs in the High Court. Tower does not oppose the cross-appeal.

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20 *Skyward* (costs), above n 5, at [18]–[19].
21 At [15].
22 At [16].
23 *Skyward* (CA), above n 2, at [54].

[48] We propose to allow the cross-appeal. Treating the litigation as a test case provided a reason for not awarding Tower costs because the litigation has been very much for its purposes (as addressing issues it plainly faces with a number of claimants). But from the point of view of Skyward, the dispute has a one-off character and, as Mr Stewart realistically accepted, with Skyward having been successful, there is no good reason why costs should not follow the event. Allowance may have to be made for Skyward's lack of success on what the Court of Appeal referred to as "question 3".

Disposition

[49] The appeal is dismissed. We answer the questions posed as follows:

(a) Under the terms of the insurance policy, on what basis is the amount payable by Tower to be calculated if [an insured party's] claim is to be settled by Tower paying the cost of buying another house?

Answer

Tower's liability is the lower of the cost of rebuilding the insured house at its present site or the cost of the other house. There is no requirement that the other house be "comparable" to the insured house.

(b) Under the terms of the insurance policy, is it Tower's choice:

(i) whether the claim is to be settled by paying the cost of buying another house?

Answer

No.

(ii) if settlement by Tower making payment is chosen, whether the payment is to be made based on the cost of rebuilding the

insured house, replacing the insured house or repairing the insured house?

Answer

If Skyward buys another house, Tower must pay the lesser of the cost of the house or the cost of rebuilding the insured house on its present site.

[50] We allow the cross-appeal. Tower is to pay Skyward costs and disbursements in respect of the High Court proceedings to be fixed by that Court.

[51] In respect of the appeal and cross-appeal, Tower is to pay Skyward costs of $25,000 and reasonable disbursements to be fixed by the Registrar.

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