

Insurers Unshaken After Red Zone Ruling *O'Loughlin v Tower Insurance Ltd*

The highly anticipated High Court decision regarding a Christchurch couple and their insurer has stopped short of a landmark ruling that would see many red zoned residents vying for the full replacement value of their homes from their insurers.

The case involved a claim brought by the O'Loughlins against their private insurer, Tower Insurance Ltd, for the full reinstatement value of their earthquake-damaged home, as opposed to the estimated repair value offered by Tower.

The O'Loughlins sued Tower on two bases. Firstly, that the designation of the house within the residential red zone constituted a total loss under their insurance policy and secondly, that the repair work proposed by Tower was not a feasible alternative to a rebuild or replacement of the house.

The High Court's decision focused on three key issues:

Whether the creation of the red zone could be considered a loss under the insurance policy

The O'Loughlins argued that the designation of their property within the Christchurch residential red zone constituted a loss which triggered a full replacement obligation by Tower under their policy.

The Court held that the primary insurance clause did not apply because the red zone designation did not cause any damage to the physical integrity of the O'Loughlins' house. Rather, it affected the way in which land and houses might be regarded in a particular area and gave the property owners in the red zone an option to sell to the Crown.

The Court drew a distinction between economic loss and physical loss, the former not being covered by the policy. The Court also dismissed an argument from the O'Loughlins, relying on an American "reasonable expectations" doctrine, that they would have reasonably expected cover against such a designation when they entered into the policy.

Whether the proposed payment of the repair cost as assessed by Tower complied with its obligations under the insurance policy

A second issue centred on Tower's assessment of the damage.

The earthquakes had caused the O'Loughlins' property to suffer severe land and structural damage which caused significant cracking and differential settlement in the house's slab foundations. Engineering experts on both sides acknowledged that there was limited construction technology available to remediate the type of liquefied ground underneath the house.

One possibility was the use of a relatively new foundation repair technique of injecting low mobility grout (LMG) into the ground to compress and increase density in the surrounding soil in an attempt to stabilise it. The issue was whether or not this technique would have been successful in repairing the foundation damage. If not, Tower would be obliged to offer considerably more to reinstate the O'Loughlins' home. The Court was influenced by whether the proposed repair work would obtain a building consent. If it would not then it was not a practical option or fair basis for the assessment of a payment to the O'Loughlins. The LMG technique was only considered as a hypothetical repair option by Tower, and detailed specifications of the work had not been developed to the required stage for submitting a building consent application.

A witness from the Christchurch City Council Building Operations Unit also gave evidence that building consent applications for red zoned land would attract a higher degree of scrutiny from the Council given the land was generally regarded as performing worse than Technical Category 3 land. There was a real prospect of the repair work not obtaining consent, with the added possibility of the repair costing more than the sum allowed by Tower.

The onus of proof fell squarely on Tower, as the insurer, to demonstrate the proposed repair work was a practical solution and, given that Tower had not provided sufficient evidence of this, the Court held that the risk of it not being successful was sufficiently high for the repair option to be excluded as a feasible solution.

The Court did not rule out the LMG method if appropriate evidence could be provided in future cases.

The sum Tower should have offered the O'Loughlins

With the repair option excluded, the O'Loughlins sought payment from Tower based on the cost of rebuilding the house on its existing damaged site, as opposed to an alternative site outside of the red zone.

The full replacement clause of the policy requires Tower to replace or reinstate the house to the same condition and extent 'as when new'. The O'Loughlins argued that the words 'as when new' obligated Tower to either rebuild the house to exactly the same dimensions and position as the existing dwelling, or pay for an identical replacement property which replicated the O'Loughlins' existing home in every respect.

Asher J read Tower's obligations in light of other provisions in the policy and noted the absurdity that could result in requiring Tower to provide an exact replica of the existing house. The Court held that a replacement home would only need to be of the same general physical condition and size as the O'Loughlins' pre-earthquake home.

The Principle in O'Loughlin v Tower Insurance Ltd

This case has been followed by many property owners looking for indications on whether they too should dispute their insurers' calculation of the loss sustained to their earthquake damaged homes.

Unfortunately for many red zoned residents, the decision came after the Crown's offer to purchase most red zoned properties had expired. Nevertheless, the case may not offer the assistance some might have hoped.

While it could be considered a victory for the O'Loughlins, the case turned on a very specific assessment of the feasibility of the unproven LMG foundation repair technique. Tower was simply unable to convince the Court that it would actually work in the circumstances.

On the other hand, insurers will likely seize upon the wider principle of this case, being that the designation of a property within the red zone does not constitute an insured loss. Insurers will therefore not be required to rebuild or replace repairable properties within the red zone.

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