Court of Appeal clarifies Notional Rebuild Costs

Many insurance policies allow either the insurer or the insured whether to elect to rebuild damaged premises on the same site, or purchase a new house elsewhere provided that the cost of the new house does not exceed the cost of rebuilding on the insured's present site. The Court of Appeal has recently clarified what can be included in the cost of rebuilding on the present site.

Avonside Holdings Limited ("Avonside") owned a rental property in Avonside Drive, Christchurch, which was damaged beyond economic repair in the Canterbury earthquakes and was red zoned. Avonside accepted the Canterbury Earthquake Recovery Authority's Option 2 and sold the land to the Crown, retaining its rights against its insurer under its insurance policy. The Policy provided that AMI Insurance Limited would:

"…pay the costs of buying another house, including necessary legal and associated fees. This cost must not be greater than rebuilding your rental house on its present site."

Southern Response, on behalf of AMI, calculated the cost of rebuilding the property without taking into account any allowance for professional fees or a contingency sum. Undamaged external items that could be re-used in the new property were also not taken into account.

Avonside took Southern Response to the High Court claiming that the calculation of rebuilding the property had been incorrectly calculated. The approach taken by Southern Response was upheld by Justice MacKenzie.

Avonside then appealed. In its judgment, *Avonside Holdings Ltd v Southern Response Earthquake Services Ltd* [2014] NZCA 483 which can be found here, the Court of Appeal decided that under the circumstances, the calculated cost of rebuilding the property:

➢ Must take into account professional fees;

➢ Must take into account a contingency sum; but

➢ Did not need to take into account external works if an 'as new' property can be produced by repairing or reinstating external works rather than rebuilding them from new.

Professional fees and contingency sums

Southern Response argued that when no actual rebuild was to take place, the exercise in calculating the equivalent cost of rebuilding was merely notional. Since it was only notional, any contingencies and / or design fees that would normally be incurred need not be included.

However, Justice Clifford, delivering the judgment of the Court, examined the relevant clauses in the policy and concluded that the cost of actually rebuilding necessarily included both the replacement cost as well as additional costs such as contingencies and professional fees. Since Avonside was entitled to the equivalent of that amount, any notional cost of rebuilding must include an allowance for professional fees and contingencies. Whether the property is actually rebuilt or not is irrelevant, the estimated costs for either option should be the same.

External works

External works represent items such as fences, walls and the driveway. Justice Clifford observed that Southern Response was liable for the full replacement cost of rebuilding or replacing the property. If Southern Response was satisfied the property could be replaced to an 'as new' condition without replacing the external works, then they may include their repair or reinstatement cost rather than the cost of rebuilding them from new.

Significance of the decision

The Court of Appeal decision goes some way to clarifying what insured parties are entitled to when they elect to purchase a new property rather than rebuild on their present site. The difference between an insurer's and an insured's approach can be tens of thousands of dollars so it pays to check and be confident any pay-out is correct.

Many insurance policies contain different clauses and wording adding to the complication. If you are considering your options under your insurance policy, or would like to know more about this decision, please contact Jonathan Nicolle, Simon Munro or another member of our litigation team.