

Lumbercorp (BOP) Limited v GIO Insurance Limited

Introduction

In 1998 GIO issued a Material Damage policy to Lumbercorp which incorporated a Subsidence memorandum, essentially covering damage caused by sudden and unforeseen subsidence of land. Around about six months after the policy was issued, Lumbercorp made a substantial claim. Indemnity was sought for structural damage to buildings forming part of a timber treatment plant in Te Puke. The damage was caused by subsidence. GIO declined the claim.

Eventually Lumbercorp issued summary judgment proceedings against GIO in respect of liability only.

The Facts

The three buildings at Te Puke were built in 1996. During construction the building subsided approximately 300mm (some 12 inches) necessitating substantial remedial work. This remedial work comprised untying the concrete floor slab from the piles supporting the superstructure of the buildings (the tying of the slab to the piles was a construction error).

In 1997 Lumbercorp were considering buying the buildings in question. During due diligence the plaintiff obtained a report from engineers (Beca Carter). The report noted:

- a. The 300mm subsidence during, and following, construction.
- b. No further settlement of the floor had been observed but settlement had not actually been monitored.
- c. The building was sited at least partly over soft peats and silts.
- d. Calculations suggested that there would be approximately 60mm of further settlement over the next decade.

Beca Carter recommended that the floor slab be monitored for continued settlement. They also recommended that the possibility of voids beneath the floor should be investigated.

Lumbercorp purchased the property and business on 1 December 1997 in reliance on the Beca Carter report.

Lumbercorp's insurance brokers invited GIO to quote for various insurances, including the buildings at Te Puke. The invitation to quote sought subsidence cover in respect of the Te Puke buildings. Subsidence cover needed specifically to be negotiated between Lumbercorp's broker and GIO. No disclosure was made to GIO directly in relation to the subsidence cover requested. In particular, Beca Carter's report was not provided to GIO.

The broker's invitation to quote attached a reinstatement valuation from valuers which included:

"Other known characteristics: Excavated and partly filled land. Engineer's report available indicating no further likelihood of ground movement."

Ultimately GIO's quote was accepted and the policy issued.

Following Lumbercorp's purchase of the property, its staff on site expressed concern that subsidence was continuing. On 19 October 1998 Lumbercorp asked another firm of engineers, Tonkin & Taylor, to investigate the possibility of continuing subsidence. Tonkin & Taylor produced a draft report in March 1999 and a final report in May 1999. The main points were:

- a. A further 200mm of settlement had occurred since the buildings were repaired. Settlement was on-going at the rate of over 50mm/year in places. Subsidence was likely to be around 50% of the primary consolidation (ie 150mm), rather than the 20% (60mm) estimated by Beca Carter. Over an eight year period, settlement of 450mm across the floor slab would occur meaning it would need to be replaced.
- b. The damage was into the "structural" category of building damage.
- c. Substantial repairs were required.
- d. The cost of remedial work would be high and there would be an on-going risk to the plant. The site may be so fundamentally unsuitable that the alternative of relocation should be considered.

The issues

Non-disclosure

GIO contended that Lumbercorp ought to have disclosed the Beca Carter report to it when it proposed for insurance. Lumbercorp argued that the reasonable insured would not have known that the report disclosed facts material to a prudent insurer.

Applying *State Insurance v. McHale*, the Judge had to consider what a reasonable insured in the position of the plaintiff would have done. The Court found:

"I consider that a reasonable insured in the plaintiff's position, seeking subsidence cover for its buildings at Te Puke would have known and appreciated that the [engineer's] report was material to a prudent insurer. Indeed, the plaintiff did not contest materiality to the prudent insurer, but rather argued that a reasonable insured in the plaintiff's position would not have known that the report was material. I am unable to accept that contention."

The Court found that the insurer should have been told about the following material facts:

1. The substantial past subsidence necessitating substantial repairs.
2. The likelihood of further secondary subsidence.
3. The existence of soft peats and silts below the building.
4. The limited scope of the engineer's investigation – ie, no drilling, sampling or structural analysis had been undertaken.
5. The need for further monitoring.

Lumbercorp tried to argue that the reference in the valuer's report to the engineer's report was adequate disclosure. The Court did not accept this proposition. Firstly, the disclosure was by Darroch and not by Lumbercorp. Secondly, it was contained in a report providing reinstatement valuation figures, not in a report providing information about subsidence. Thirdly, the report was not specifically drawn to GIO's attention. Fourthly, and most importantly, the valuer's report did not accurately summarise the Beca Carter report.

As a result the Judge held that there was a reasonably arguable defence available to GIO on the non-disclosure defence. Interestingly, the Judge went further saying that there was "a clear breach" of the duty of disclosure.

Subsidence Memorandum

The relevant Memorandum read as follows:

"This Policy extends to cover loss or damage to any of the Insured Property consequent upon sudden and unforeseen subsidence of land beneath or adjacent to the property ..."

Lumbercorp accepted that "ordinary" or "normal" subsidence was excluded from coverage.

The first issue decided was what "unforeseen" meant. GIO argued that the subsidence that occurred was only that predicted in Beca Carter's report, although perhaps greater in magnitude. Thus the damage had been foreseen by Beca Carter. Lumbercorp argued that no reasonable insured which had read the Beca Carter report could have foreseen the subsidence which actually occurred. Lumbercorp made the point that it would not have purchased the property had it foreseen the subsidence and resulting damage which occurred. The Judge preferred Lumbercorp's argument.

The argument as to the meaning of "sudden" went rather better for GIO. Numerous cases were cited by both parties; some of which are referred to in the judgment. Basically though there were two possible meanings. The primary one being an absence of foreseeability or warning, the secondary one the temporal meaning "instantaneous".

Ultimately the Judge said it was a matter of construction to interpret the words used in the particular policy by the particular parties with the relevant knowledge they had at the time they entered into it. In the Judge's view sudden meant "abrupt", "all at once", "instantaneous" and thus GIO's argument prevailed.

The Judge came to this view for two reasons. Firstly to interpret "sudden" as meaning "unforeseen" or "unexpected" creates a tautology – the phrase would become effectively "unforeseen and unforeseen". The Judge concluded that such a tautology was unlikely here where the word "sudden" has a different and more obvious meaning, when it is used in conjunction with the word "unforeseen". The second reason is that normal or ordinary subsidence – ie, "slow" subsidence - is excluded under the policy. Thus, logically, it must be rapid or abrupt subsidence which is the risk covered.

The Judge therefore concluded that GIO had a reasonably arguable defence on the Subsidence Memorandum. Lumbercorp's application for summary judgment therefore failed.

Comment

As everyone involved in the insurance industry knows, the words "sudden and unforeseen" are used frequently. So are various variations of those two words. The words are infrequently ruled upon by New Zealand Courts and so this decision is of some interest.

Lumbercorp has filed an appeal and so the Court of Appeal will be asked to consider the issues. The outcome of the appeal should be of great interest to the insurance industry in New Zealand.

Wellington City Council v FAI General Insurance (NZ) Ltd – The Question of Excess

Introduction

Where an insured claims indemnity from its insurer in respect of losses sustained as a result of several claims made against it, the question that arises is whether the insured is liable for payment of excess in respect of each claim made against it. Earlier case law held that because each claim against the insured was the result of a separate cause of action, the insured was liable for excesses in respect of each claim against it (for example, Haydon v Lo & Lo).

However, McGechan J recently concluded that the question should be instead considered in light of the reality of the situation (Wellington City Council v FAI General Insurance (NZ) Ltd). If the claims are, in reality, one composite claim, then the insured is only liable for one payment of excess.

The Facts

Wellington City Council (“WCC”) and FAI General Insurance (“FAI”) entered into a Legal Expenses Policy, whereby FAI agreed to insure WCC for losses sustained during legal proceedings between WCC and its employees. Cover was excluded for “any award of compensation pursuant to a contract of employment in respect of . . . [any] redundancy payment.”

As part of restructuring its public services, WCC incorporated a company to operate its public transport network. Employees of WCC were made redundant and then employed by the new company. At the time, WCC and the New Zealand Tramways and Public Passenger Transport Authorities Employees Union were parties to a redundancy agreement. This agreement meant that WCC was required to make redundancy payments to the employees when it terminated their employment, however it failed to make such payments.

After the restructuring, the Income Tax Amendment Act (No 4) 1992 came into effect. Under that Act, redundancy payments became taxed at the “extra emolument rate.” Payments that would have previously been taxed at a special rate became taxed at a higher rate.

The former employees commenced proceedings in the Employment Tribunal arguing that they were entitled to redundancy payments under the agreement between their union and former employer. Ultimately the Court of Appeal ruled that not only were the employees entitled to redundancy payments, but also that the payments were taxable under the new legislation. Consequently, WCC was liable for an additional \$416,699.91 in tax that it would have avoided had payments been made at the correct time. WCC sought to recoup this sum from FAI under its Legal Expenses Policy.

McGechan J held that there was no coverage under the policy because it was only intended to cover costs incurred in legal disputes between the plaintiff and its employees. Nonetheless he also considered whether the excess under the policy would have been payable by WCC in respect of each employee's claim, or only in respect of one combined claim.

The Case Law

Departure from the approach exemplified in A & NZ Bank v Colonial Wharves had previously occurred in Haydon v Lo & Lo. An employee of the defendant solicitors committed 43 acts of theft against the defendants, which were the subject of a claim by the plaintiffs against the defendants and thus by the defendants against their insurers. The Privy Council reasoned that separate claims against the insured did not necessarily exist whenever a separate cause of action arose. The Privy Council decided it seemed "unnatural" to say that there were 43 separate claims when only one perpetrator and one victim existed. The "reality" according to the Privy Council was that there was only one claim, and therefore, only one excess payable by the insured.

In his decision, McGechan J adopted this approach. He argued that the court does not look simply to the number of claims against the insured. Rather, it considers whether the assertion of multiple claims is "natural" or "unnatural." McGechan J considered that the question was finely balanced.

On one hand, there were 24 employees each asserting a separate claim against their former employer. No one employee could assert rights against the rights of the other 23 to claim a redundancy payment. The amount that each employee claimed was different. The employees would have "[guarded] their individual claims as something pursued by [them] in its own right, even if concurrently with others."

On the other hand, the claims all arose out of the same employment contract. The claims were mounted concurrently and all raised identical liability issues. WCC argued that it was "unnatural" to treat the claim as 24 separate claims because each claim was "one particular facet of a rather unattractive gem." FAI argued that incorporation of the separate causes of action had occurred for convenience, and a third party's decision should not bind an insurer.

The judge concluded that he would be "straining reality" to hold that all the claims by the employees were one claim and that, had he decided that there was cover under the policy, WCC would have had to pay an excess in respect of each of the 24 claims.

Conclusion

Applying the new test, McGechan J reached the correct conclusion on the "reality" of the situation. Each employee had a separate claim for a separate amount of redundancy pay. The claims were brought concurrently simply for convenience. Most significantly, while the plaintiff would have viewed the claims as an amalgamated claim with one total bill to be paid, each employee

would have considered that his or her claim was distinct from that of his or her fellow claimants. Each employee would have asserted that he or she was entitled, not to the total amount owed, but to his or her share of that total.

It is now more difficult for an insurer to determine the number of excesses to apply because separate causes of action against an insured do not automatically mean that the insured must pay an excess in respect of each claim. However as McGechan J did not need to consider this issue in order to reach his decision, it may be that future cases do not follow his reasoning. The law, as so often seems to be the case, is far from clear.

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