Australian
Insurance
Law Bulletin

Xu v IAG New Zealand Ltd — should the principle precluding assignment of the reinstatement benefit be overturned?

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In *Xu v IAG New Zealand Ltd*[1] (*Xu*), the New Zealand Supreme Court considered whether the principle in *Bryant v Primary Industries Insurance Co Ltd*[2] (*Bryant*) that a replacement benefit may not be assigned where the insured does not restore the property[3] ought to be overturned.

In *Bryant*, a vendor who had insured his property had the misfortune of having his property destroyed by fire on the morning of the auction. Despite its destruction, the property was sold at auction[4] and the vendor assigned the benefit of the policy to the purchaser. At issue in the Court of Appeal was whether the purchaser was entitled to be indemnified under the policy based on a reinstatement or replacement of the property. The New Zealand Court of Appeal held that the purchaser was not entitled to be indemnified on a reinstatement basis because the vendor had sold the property without rebuilding.

The outcome in *Bryant* was premised on two principles. First, under a contract of insurance, an insured can never be entitled to more than his actual loss.[5] Secondly, the entitlement to reinstatement or replacement value was subject to the proviso that "if the insured was unable or unwilling to effect reinstatement or replacement of the property, the insurer was under no liability in respect of this item of insurance." The purchaser was only entitled to be assigned whatever assignable rights had accrued to the vendor at the time of the assignment.[6] As the vendor did not reinstate the property, there was no entitlement to be indemnified on the reinstatement basis to be assigned.[7]

The New Zealand Supreme Court is split

In *Xu*, the New Zealand Supreme Court had to determine whether the purchasers of a home in Christchurch that had been damaged by earthquakes were entitled to be indemnified by a policy of insurance taken out by the vendor on a reinstatement basis. The property had been damaged and the insured vendors had never had any intention of reinstating the property. Three years later, the insured sold the property.

The policy of insurance held by the vendors was subject to a similar proviso in *Bryant*. If the insured did not restore the property, then the insurer would pay the *lesser* of the amount of the loss or damage or the estimated cost of reinstatement.[8]

The court by a majority of 3:2 held that the purchaser was not entitled to the reinstatement benefit under the policy. William Young, O'Regan and Ellen France JJ said that *Bryant*, which they declined to overturn, stood in the way of the purchaser's claims.[9]

Bryant had been decided on two bases:[10]

- first, that assignability of the right to the replacement benefit would infringe the indemnity principle in that insurance only covers loss suffered by the insured and this would not cover a loss suffered by an assignee
- secondly, that the entitlement to reinstate and be reimbursed for the cost was personal to the insured (as opposed to the assignee)

The majority said that the indemnity principle is of continuing significance and application in indemnity insurance.[11] This is despite the fact that the indemnity principle is "not easy to apply" in the context of replacement insurance given that replacement insurance had not been available at the time Brett LJ in *Castellain v Preston*[12] emphasised that the indemnity principle was a "fundamental principle" of insurance.[13]

After considering the nature of replacement insurance and the indemnity principle, the majority said that "[i]t may thus be better to just accept that replacement insurance is an exception to the indemnity principle."[14] The majority were however attracted by the idea that the indemnity principle addresses the issue of moral hazard that replacement insurance creates.[15] It seems that the larger amounts insured would provide greater scope for deception and fraud.[16] This is a curious justification as

insurers would be entitled to avoid the policy if deception and fraud were proved.

At the end of the day, the majority held that as a matter of construction, the entitlement to replacement benefits was conditional on reinstatement by the insured. In their view, this insistence on reinstatement is rational given the moral hazard associated with replacement insurance. The majority however acknowledged that the market was now offering replacement policies in which the recovery of benefits is not legally dependent upon personal reinstatement by the insured.[17]

A condition in the policy that provided that where a contract for sale and purchase of the home had been entered into, a purchaser shall be entitled to replacement benefits of the policy provided that the purchaser complies with all the conditions of the policy, did not assist the purchaser. It is uncontroversial that the purchaser and vendor both have an insurable interest in the property between exchange and settlement as the equitable interest in the property passes to the purchaser upon exchange. On a construction of the policy, the condition only extended cover during this period and the extended cover ended on settlement.[18] Further, the cover only applied to events which occurred during this period.[19]

The minority

By contrast, the minority judges, Glazebrook and Arnold JJ, held that the replacement benefit had accrued at the time that the house was damaged.[20] The minority also did not accept that the insured had not suffered any loss. Instead, they took the view that the loss had occurred at the time of the earthquakes and the loss was presumably reflected in the sale price of the property.[21] The author thinks that there is force in these points. It is likely that the damage to the property and the time and cost of rebuilding would have been factored into the sale price even if the vendor and purchaser had agreed that the benefits of the policy would be assigned to the purchaser.[22]

The minority accepted that the replacement benefit was conditional upon restoration and the insured had no intention of restoring the property. However, this did not prevent the benefit from being assigned.[23] For the minority, the obligations were not so obviously personal in character that they had to be performed by the insured. In their view, the loss had already occurred and the benefit had accrued. The assignee could satisfy the condition of restoration.[24] This view is difficult to reconcile with the express wording in the policy. It also means that both the benefit and the burden of the policy would be assigned effectively causing a novation of the insurance policy to the purchaser. Finally, the minority did not consider that the moral hazard argument prevented assignment of the replacement benefit.

Conclusion

The principle that a replacement benefit cannot be assigned if the insured does not satisfy the condition precedent of restoration of the property remains intact. The practical effect of this is that the replacement benefit may never be assigned. It is difficult to reconcile this principle with the fact that the cause of action under the indemnity policy accrues on the occurrence of the event and not when the insured elects between remedies. In circumstances where the policy premium has been paid, the property has been damaged and the purchaser intends to restore the property thereby satisfying the condition precedent, it seems to the author that the only party to the policy benefiting from the application of the principle in *Bryant* is the insurer. Nevertheless, it will be up to the market or the legislature to address this issue.

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Footnotes

1. *Xu v IAG New Zealand Ltd* [2019] NZSC 68; BC201961467.
2. *Bryant v Primary Industries Insurance Co Ltd* (1990) 6 ANZ Ins Cas 60-972.
3. This principle also represents the law in Australia: see *Ziel Nominees Pty Ltd v VACC Insurance Co Ltd* (1975) 180 CLR 173; 7 ALR 667; BC7500069.
4. It is unknown whether the price at which the property was sold reflected the destruction of the home on the property.
5. Above n 2, at 76,465.
6. Above n 2, at 76,465.
7. Above n 2, at 76,465.
8. Above n 1, at [1].
9. Above n 1, at [5].
10. Above n 1, at [10].
11. Above n 1, at [14]. Under the indemnity principle, policies are construed in such a way as to avoid insurers paying more than the insured has actually lost.
12. *Castellain v Preston* (1883) 11 QBD 380.
13. Above n 1, at [14].
14. Above n 1, at [20].
15. Above n 1, at [21].
16. Above n 1, at [23].
17. Above n 1, at [45].

18. Above n 1, at [54].
19. Above n 1, at [56].
20. Above n 1, at [89]. See the case note on *Globe Church Inc v Allianz Australia Insurance Ltd* (2019) 365 ALR 750; [2019] NSWCA 27; BC201901162 where the author discusses when a cause of action accrues under a policy: L Chan "Globe Church Inc v Allianz Australia Insurance Ltd" (2019) 34(10) *ILB* 125.
21. Above n 1, at [97].
22. If this had indeed been the basis upon which the parties had contracted, then this might raise issues of restitution or unjust enrichment as the parties had clearly contracted upon a mistaken basis.
23. Above n 1, at [98].
24. Above n 1, at [98], [108], [117].