THE MEASURE OF INDEMNITY UNDER PROPERTY INSURANCE POLICIES

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A large proportion of disputes in the insurance arena relate to the *quantum* recoverable under the policy in question; that is, what is the measure of indemnity and how is this figure to be arrived at? For example, if a building is destroyed by an insured peril, is the basic measure of indemnity the cost of reinstating the building less an allowance for betterment[1] or is the correct basis for assesment the market value of the premises at the time of its destruction? Due to the notoriously high cost of rebuilding in these times of inflation there may be a significant difference in the *quantum* recoverable depending on what basis for assessment is employed. Issues of this kind lie at the heart of numerous law suits and have engendered a multitude of articles and a considerable volume of correspondence in legal and other professional journals.[2] This article looks at the legal principles pertaining to the assessment of an insured loss under policies of property insurance and at some particular areas of difficulty.

(1) *Valued Policies*

As a general rule the insurer is liable to indemnify the insured only in respect of the actual loss he has suffered.[3] However, this rule may be departed from where a valued policy is effected and the policy provides for the payment of a fixed sum in the event of a loss irrespective of whether there has been any fluctuation in value, either up or down, during

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[1] Any building or article restored to its original state will almost inevitably be an improvement on the building or article as it existed at the time of the occurrence of the insured peril, as new materials will have been used to replace old. In the absence of an express policy provision to the contrary, allowance must be made for the "betterment". See for example: *Ewer* v *National Employers' Mutual General Insurance Association Ltd* [1937] 2 All ER 193, 203; *Reynolds and Anderson* v *Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep. 440, 453. In marine insurance, custom has fixed an allowance of one-third "new for old" which is said to be deductible. See *MacGillivray & Parkington on Insurance Law* (7 ed, 1981), 645.

[2] See, for example: *Falcon Investments Corpn (NZ) Ltd* v *State Insurance General Manager* [1975] 1 NZLR 520; *Ziola* v *Co-Operative Fire and Casualty Co.* (1976) 6 WWR 159; *Leppard* v *Excess Insurance Co Ltd* [1979] 2 All ER 668; *Mercantile Mutual Insurance Co Ltd* v *Amburla* (1982) 2 ANZ Insurance Cases 60-429; Lewis, "A Fundamental Principle of Insurance Law", [1979] LCMLQ 275; Robinson, "The Measure of Indemnity", [1980] 8 The Adjusters Journal 15; Smith, "Actual Cash Value", [1980] 8 The Adjusters Journal 18; Lakeman, "Measure of Indemnity", [1980] 8 The Adjusters Journal 2.

[3] The insured is not entitled to make a profit at the expense of the insurer; he is entitled to be fully indemnified, but never more than fully indemnified. See, for example, *Anderson* v *James* (1908) 28 NZLR 34, 42; *British Traders' Insurance Ltd* v *Monson* (1964) 111 CLR 86, 92-94.

the currency of the policy.[4] As Lord Selborne observed in *Burnard* v *Rodocanachi, Sons & Co.*[5]

> "For the purpose of the contract of insurance and for the purpose of all rights arising from that contract it may well be that the valuation in a valued policy is conclusive, and the effect of it may be that for those purposes the assured is not entitled to say 'my loss has been greater than that which has been covered by the policy'."

The main argument in favour of such "agreed value" policies is that they may enable the parties to sidestep the quagmire of a complicated and protracted dispute as to the amount of an insured's loss.[6] The principle that agreed values are binding in the absence of fraud does create problems and the Australian Law Reform Commission suggested recently[7] that by allowing an insurer to challenge an agreed valuation on the ground that it was substantially different from the true value at the time of the loss might resolve some difficulties. On balance though, the Commission was of the opinion that "the questions of limitations upon valued policies is a matter best left to be dealt with by the terms of the insurance contracts themselves".[8]

In the event of a total loss of the subject matter of an "agreed value" insurance policy the insurer is liable to pay the amount stipulated in the policy as reflecting the subject matter's value. Where partial loss only is sustained it was decided in *Elcock* v *Thomson*[9] that the agreed value should also be applied, the insurer being liable for that proportion of the agreed value as is represented by the depreciation in the actual value in the subject matter; that is, the fraction of the actual loss to the actual value is applied as a fraction of the agreed valuation.[10]

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[4] See *Maurice* v *Goldsborough Mort & Co. Ltd* [1939] AC 452, 466-467 (PC); *Elcock* v *Thomson* [1949] 2 KB 755, 760.

[5] (1882) 7 App. Cas. 333, 335. Morris J stated in *Elcock* v *Thomson*, supra, at 761, that "when parties have agreed on a valuation, then, in the absence of fraud or of circumstances invalidating their agreement they have made an arrangement by which, for better or for worse, they are bound".

[6] The insured is dispensed therefore from the necessity to demonstrate or deal with questions of amount, and is entitled, on proving the fact of his loss, to recover the full amount insured upon the subject matter of the insurance. See Welford and Otter-Barry, *The Law Relating to Fire Insurance* (4 ed. 1948), 263: *MacGillivray & Parkington on Insurance Law, op.cit.*, 642.

[7] *Report on Insurance Contracts* (1982); para 133.

[8] *Idem.*

[9] *Supra* at 763-764; see also *Compania Astra S.A.* v *Archdale* [1952] 2 Lloyd's Rep. 95.

[10] For example, a property insured for $100,000 which is worth $50,000 before loss and $30,000 afterward will attract a recovery of $40,000; that is, two fifths of the agreed value. Modern policy wordings, however, often avoid the effect of the decision in *Elcock's* case by providing that in the event of partial loss the basis of settlement shall be the actual cost of repair. See James, "Indemnity Past and Present", [1981] 9 The Adjusters Journal 45.

Valued policies are most commonly found in marine as opposed to non-marine insurance[11] but in every case it is a question of construction of the particular policy concerned as to whether or not it is a valued policy. A policy is a valued policy only if the parties have expressly agreed that the property is assumed to have a certain value attached to it; but the valuation need not be a precise figure provided it is capable of being objectively determined.[12] Conversely, the ascription of particular values to items in an inventory of household effects does not, by itself, convert a policy covering such effects into a valued one in respect of the values placed on the items in the inventory, for, as Sutton observed, "the figures are usually evidence of value as at the date of the policy only and some allowance must be made for depreciation from that time until the date of the loss".[13] In practice non-marine policies of the agreed *value genue* are confined to policies covering very expensive items of property, such as jewellery, the value of which might be extremely difficult to assess at the time of the loss.

(2) *The Principle of Indemnity*

Save in the case of a valued policy under which the agreed value is to be paid in the event of a loss, the insurer is under an obligation to indemnify the insured only against his *actual* loss from the accepted risk; the insured must be restored, subject to the terms and conditions of the policy, to the financial position which he enjoyed immediately before the realisation of the peril insured against. The following matters are of primary importance in the assessment of the insured's loss in connection with insurances over real or personal property.

(a) *Sum insured*

The amount of insurance specified in the policy does not necessarily represent the measure of indemnity as the figure for which the subject matter is insured merely indicates the maximum amount for which the insurer will be liable; the insured must still prove the extent of his loss.[14] Generally an insurer will accept an insured's valuation of the subject matter of insurance for purposes of fixing the sum insured; it matters little to the insurer if there is an over-valuation by the insured as the insurer's

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[11] As a matter of practice hulls and cargoes are insured on an agreed value basis; the concept of market value has never been of great importance in the marine insurance area and a shipowner will insure a vessel for a figure which represents its value to him, and such value is much more dependent on earning capacity than on market value of the vessel at the commencement of the insurance. See James, *loc. cit.*, 45; Sutton, *Insurance Law in Australia and New Zealand* (1980), 4.

[12] In *Loders & Nucoline Ltd* v *Bank of New Zealand* [1929] 33 Lloyd's Rep. 70, 73 it was held that insurance "at the contract price" of goods shipped amounted to a valued policy; see also *Blascheck* v *Bussell* (1916) 33 TLR 74; *City Tailors Ltd* v *Evans* (1921) 126 LT 439; *Leppard* v *Excess Insurance Co Ltd, supra.*

[13] See Sutton, *op.cit.*, 528; Thomas, *Guidebook to Insurance Law in Australia and New Zealand* (1981), 6; Birds, *Modern Insurance Law* (1982), 229.

[14] See *British Traders' Insurance Co Ltd* v *Monson, supra; Dawson* v *Monarch Insurance Co of N.Z. Ltd* [1977] 1 NZLR 372, 377.

obligation in the event of a loss is to recompense the insured for his actual loss up to the stated maximum. In the converse situation where there is an undervaluation insurers have sought, through average clauses in particular,[15] to limit their liability. The amount of insurance therefore, is relevant in the determination of the premium payable and in setting a ceiling on the amount recoverable in respect of any loss.[16]

(b) *Insurable interest*

The insured is entitled to be fully indemnified but never more than fully indemnified. The primary purpose of insurance is to protect the insured from the economic consequences of fortuitous events and it follows from this that the insured must have an *interest* in the subject matter of insurance, for without such an interest, the insured cannot suffer a loss and hence can obtain no indemnity.[17] However, it is a moot point whether the current legal boundaries as to what constitutes an insurable interest in property are wide enough. At present an insured must show a strict proprietary interest in, or some legal or equitable relation to, the subject matter of the insurance.[18] It is not enough for an insured simply to demonstrate that he benefits or stands to benefit from the existence of the property or would suffer a loss by its destruction — he must establish that he has, in addition, a legally enforceable claim or right in respect of it, or some legal liability to make good the loss. For example, in *Macaura* v *Northern Assurance Co. Ltd*[19] a shareholder who owned the vast majority of shares in a company and who insured the only major asset of the company in his own name, was held unable to claim for loss suffered by fire on the ground that he possessed no insurable interest in the asset. Lord Buckmaster emphasised that a shareholder has no legal or equitable interest in company property.[20] In one sense, of course, such a majority shareholder has a very substantial interest in the preservation of a company's assets in that he may be directly prejudiced by their destruction; but, in the legal sense there is no enforceable claim or right in respect of the property to support an insurable interest. The current position as regards insurable interest may be too restrictive and it is interesting to note that the Ausralian Law Reform Commission have suggested that the "abandonment of

[15] Average clauses are discussed below; see also *Timms* v *F.A.I. Insurances Ltd* (1976) 12 ALR 506 (clause requiring insured to give a warranty of value when insuring; held not to have been breached where the insured has acted reasonably and has made a realistic and honest estimation of value).

[16] Only if the insured suffers an actual loss equal to or exceeding this ceiling on recovery will the insurer be liable for the amount of insurance as specified in the policy. Generally, see, Welford and Otter-Barry, *op.cit.*, 294.

[17] The requirement of an insurable interest distinguishes contracts of insurance from wagering contracts; that is, the insured enters into the contract of insurance to protect himself from the economic consequences of fortuitous events and does not create the risk of loss by entering into the contract. See *Davjoyda Estates Pty Ltd* v *National Insurance Co of N.Z. Ltd* (1965) 69 SR (NSW) 381, 421.

[18] See Birds, *op.cit.*, 37; *MacGillivray & Parkington on Insurance Law, op.cit.*, 119; Sutton, *op.cit.*, 213; *Thomas, op.cit.* 79.

[19] [1925] AC 619.

[20] *Idem*, 626; see also the judgment of Lord Sumner at page 630.

the strict proprietary interest test in favour of one based on economic loss would allow more flexibility to insurers and the insuring public, without in any way promoting gaming and wagering in the form of insurance or adding to the risk of destruction of the property insured".[21] There seems to be little prospect of New Zealand following suit in this regard.[22]

Therefore, the prevailing principle at this time is that the nature and extent of the insured's legally recognised interest in the subject matter of insurance will determine the amount recoverable by him as the obligation of the insurer is to indemnify the insured in respect of his actual loss and the insured cannot make a profit at the expense of the insurer. However, in certain circumstances, a person with a limited interest can insure for and recover the full value of the subject matter of insurance.[23] If at the time the contract of insurance was effected the person insuring intends to protect not only his own limited interest but also the interests of other persons in the same subject matter, he may insure for and recover the full value, subject of course to any contractual or statutory provision to the contrary.[24] Save for this exception, the value of the insured's interest in the subject matter of insurance will determine the amount of the indemnity.

(c) *Loss suffered by the insured*

The fact that the measure of indemnity is the *loss suffered by the insured*, and not necessarily the value of the subject matter destroyed or damaged by the peril insured against, poses difficult questions of assessment. These questions may be canvassed under the following heads: (i) Buildings; (ii) Household and personal effects, and (iii) Stock in trade.

(i) *Buildings*

In *Falcon Investments Corpn (NZ) Ltd* v *State Insurance General Manager*[25] the insured purchased a property with an old house thereon with a view to the redevelopment of the land involving the demolition of the old house and the erection of a number of flats. Planning permission and a

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[21] *Report on Insurance Contracts* (1982), para. 120.

[22] The Contracts and Commercial Law Reform Committee recommend in their Draft Insurance Law Reform Bill that an insurable interest be required in respect of all contracts of insurance, apart from life assurances. See clauses 6 and 7 of the Draft Bill which is produced as Appendix A to the Committee's Report, *Aspects of Insurance Law* (2), 19 May 1983.

[23] See, for example; *Waters* v *Monarch Fire and Life Assurance Co* (1856) 5 E & B 870; *Tomlinson (Hauliers) Ltd* v *Hepburn* [1966] AC 451; Marine Insurance Act 1908, s.15(2).

[24] See Sutton, *op.cit.*, 222-224. The person insuring property for its full value is accountable to other persons having interests in the property in respect of any balance recovered over and above the value of his own interest. The legal basis for such accountability is unclear; that is, whether he is a trustee for the interests of other persons in the property, or whether he must account in quasi-contract for money had and received, or whether it is a question of agency. See *Tomlinson (Hauliers) Ltd* v *Hepburn, supra*; *Waters* v *Monarch Fire & Life Assurance Co., supra*, 881.

[25] [1975] 1 NZLR 520.

building permit were obtained for such redevelopment and pending the institution of this redevelopment programme the house was let at $50 per week and fire insurance cover was taken out with the defendant insurer which provided for an indemnity to a maximum amount of $12,000. Before matters had proceeded far, the tenant caused $500 damage to the house and three days later it was so badly damaged by fire as to be incapable of repair. The cost of demolition of the house before the fire would have been $650, and after the fire it was $315. Under the development programme the house would not have been demolished for a year and until demolition would have produced rental income for the plaintiff. O'Regan J accepted that the intrinsic value of the dwellinghouse was $6500[26] but disregarded the evidence of two public valuers to this effect as the learned judge observed that his task was to ascertain *the loss to the assured* which was quite distinct in this case from the intrinsic value of the house destroyed. This loss was assessed as the loss of rent from the house during the twelve months it would have been let before being demolished, less the cost of making good the depredations of the tenant to make it habitable, and less the saving in demolition costs resulting from the fire.

This case may be contrasted with the recent decision of the Queensland Supreme Court in *Mercantile Mutual Insurance Co Ltd* v *Amburla*.[27] A small house and its contents, insured with the appellants for $7,000 under a combined houseowner's and householder's policy, was destroyed by fire. The appellants appealed against a finding of a District Court that the loss amounted to $7,000. One of the grounds of appeal was that the evidence before the District Court did not support an assessment of the respondent's loss at that figure in that the insurers contended that the value to the insured had to be assessed in terms of what he intended to do with the house. A substantial body of evidence was to the effect that the insured proposed moving another house from a different location onto the same land which necessarily would have entailed the demolition of the house destroyed by fire, or its removal. That is, the insurers established that the insured: (i) had obtained City Council approval to move a larger house onto the land in question; (ii) had lodged a building application and plans in respect of this larger house; (iii) had applied for a road permit to shift the larger house, and; (iv) had entered into an agreement for the purchase and removal of this larger house. As against this body of evidence was the insured's avowal in court that he intended to continue to live in the small house on the property and intended to move the larger house onto the same property temporarily only. The insurers contended that it could not be said that it was the intention of the insured to continue to use the small house as a dwelling and unless that were the intention it could not be said that the loss to the insured was the loss of the house *in situ*. Consequently the insurers argued that if it had been intended to demolish the house then it must have been of no value; and if it had been intended to remove it then there was no evidence to support a value of $7,000 after the costs of removal had been incurred.

[26] *Ibid*, at 522.

[27] (1982) 2 ANZ Insurance Cases #60-469.

However, the Supreme Court of Queensland unanimously dismissed the insurer's appeal. Connolly J., with whom Sheahan J. concurred, held that the law does not require for the purpose of assessing the value of property to an insured, a valuation which accords with the subjective intentions at the moment of loss. He went on to remark that:

> "A contrary view would mean that where an insured has valuable property destroyed by the occurrence of an insured risk his claim may be defeated by the proof that he was not putting it to productive use and at the relevant time did not intend to do so."[28]

Connolly J. distinguished the *Falcon Investments* case on the basis that the particular facts of that case justified a conclusion that the house located on that land was of nuisance value only. However, he was not prepared to hold that the District Court were wrong in this case in assessing the measure of indemnity at $7,000. Campbell J., while recognising that the intention of the insured at the time of the loss was relevant, was not convinced that the evidence supported a conclusion that the insured intended to demolish or remove the house;[29] therefore the award of $7,000 was appropriate in the circumstances of this case. Leaving aside the evidential dispute in this case, it is respectfully submitted that Connolly J. is wrong in asserting that no account must be taken of the insured's "subjective intentions at the moment of loss".[30] Notwithstanding the formidable obstacles entailed in undertaking an enquiry into the state of mind of the insured at the relevant time, it is suggested that this enquiry is essential if a proper assessment is to be made. There is abundant authority for the proposition that the indemnity payable is the loss suffered by the insured[31] — the ascertainment of this amount necessitates an enquiry into the nature of the insured's interest in the subject matter of insurance, the use to which the subject matter was put and the intentions of the insured.

Consider the following recent cases: In *Leppard* v *Excess Insurance Co. Ltd*[32] the owner of a cottage attempted to sell it for £12,500 but was eventually obliged to reduce his asking price to £4,500. The cottage was insured against fire and other risks for a total of £14,000 under an indemnity policy which stated that the sum was not less than the full value, defined as "the amount which it would cost to replace the cottage in its existing form should it be totally destroyed". The cottage was destroyed by fire before the owner could sell it. The insurers accepted liability but contested the owner's claim for either the full value of the property as defined in the policy or the cost of reinstatement. They contended that he was entitled

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[28] *Ibid*, at 77, 674-77, 675.

[29] *Ibid*, at 77, 672. Campbell J observed that the insured's application to the Council may not have disclosed his real intention in that Council regulations precluded the temporary location of houses on such property; therefore his application to move the larger house onto the property in question did not necessarily demonstrate that he intended to demolish or remove the existing smaller house.

[30] *Ibid*, at 77, 673. The expression is that of Connolly J.

[31] See *Falcon Investments Corpn (NZ) Ltd* v *State Insurance General Manager*, *supra*; *Ziola* v *Co-Operative Fire & Casualty Co* (1976) 6 WWR 159; and the cases cited below.

[32] [1979] 1 WLR 512.

only to the market value of the cottage at the time of the fire, which it was agreed was £3,000. Megaw LJ., in accepting that the proper award was this sum, stated that the fundamental principle of insurance required that the plaintiff could only recover his actual loss and the definition in the policy as to full value merely laid down the maximum amount recoverable. The real question was:

> "Was the plaintiff's actual loss the cost of reinstatement of the cottage? Or was it. . .the market value of the property as it was at the time of the fire? . . .this is a question of fact, and. . . one must look at all the relevant facts of the particular case to ascertain the actual value of the loss at the relevant date. Of course, *one is entitled to look to the future* so as to bring in relevant factors which would have been foreseen at the relevant date as being likely to affect the value of the thing insured. . .".[33]

The learned judge held that if the plaintiff recovered the cost of reinstatement he would not only be indemnified against his loss but would also recover a windfall, for as he had been willing to sell the property for £3,000 (not including the land value) why should he recover more upon its destruction? Geoffrey Lane LJ. and Dunn J. concurred. While this case does not establish any general principle to the effect that market value is the correct basis for settlement it does demonstrate that an insured by his conduct (such as offering the cottage for sale at £4,500) may reveal what he considers the value of the property to be to him.[34] Obviously the insured may have changed his mind and elected not to sell but this did not preclude the court from having regard to his intentions at the time when the loss was sustained.

Another case meriting attention is *Reynolds and Anderson* v *Phoenix Assurance Co. Ltd*[35] where an insurance of an old maltings was in issue. A fire occurred which destroyed about 70 per cent of this building and the appropriate measure of indemnity fell to be determined. During the course of the hearing three possible ways of gauging the indemnity were canvassed. The first was to use market value, which would be difficult to assess, there being no ready market for buildings such as maltings, but which would be considerably less than the cost of reinstatement. The second method was to look at the purpose for which the malting was to be used and then find out what type of alternative accommodation could be erected to fulfil that function. This the court described as equivalent modern replacement value — again this would involve a sum considerably less than reinstatement cost. The third was the cost of reinstatement which was the most expensive method. The court held that the true measure of indemnity involved the payment of sufficient funds to reinstate the building substantially as it was before the fire, as the insured in this case had a genuine intention to reinstate. Forbes J. made the following observation:

> "To force an owner who is not a property dealer to accept market value if he had no desire to go to the market seems to be a conclusion which one should not

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[33] *Ibid*, at 519-520. The cost of reinstatement less an allowance for betterment was £8,694.

[34] See James, *loc.cit.*, 46.

[35] [1978] 2 Lloyd's Rep. 440.

easily arrive at. At the same time the cost of reinstatement cannot be taken as inevitably a measure of indemnity. There must be cases where no one in his right mind would contemplate rebuilding if he could re-establish himself elsewhere. The question of the proper measure of indemnity becomes a matter of fact and degree to be decided on the circumstances of each case."[36]

Finally, mention should be made of *Pleasurama Ltd* v *Sun Alliance and London Insurance Ltd*[37] where the court held that in certain cases the only basis for assessment is the cost of reinstatement less an allowance for depreciation. The building destroyed in this case was a Bingo hall and in the absence of sufficient evidence of market value for established Bingo halls the only means whereby the actual loss to the insured could be assessed was to measure the cost of reinstatement less an allowance for betterment.

The cases discussed above demonstrate conclusively that the measure of indemnity is the loss suffered by the insured and not necesarily the value of the subject matter destroyed or damaged by the peril insured against. In determining the loss to the insured there is no room for the application of some hard and fast rule. In each case the proper measure of indemnity is a matter of fact and degree. It would seem that if the insured has a genuine intention to reinstate he is entitled to have his loss settled on that basis taking into account depreciation — clearly where the premises are occupied by the insured for his own use and enjoyment or for the purpose of carrying on his trade or business, the insured cannot continue to use and enjoy the premises or carry on his business unless the property is reinstated, and the cost of this may be substantially more than the market value. Finally, in determining the loss to the insured it is submitted that account may be taken of his intentions,[38] his conduct[39] and the nature of the subject matter of insurance.[40]

(ii) *Household and Personal Effects*

In the case of a total loss of household effects or some other chattel the measure of indemnity will *prima facie* be the market value of the property lost or destroyed at the time[41] and place[42] of the loss. This is the appropriate yardstick as the insured can go into the market and by purchasing

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[36] *Ibid*, at 451.

[37] [1979] 1 Lloyd's Rep. 389.

[38] See, for example, the *Falcon Investments, Phoenix Assurance Co* and *Leppard* cases, as well as the recent decision of the Supreme Court of Victoria in *Toollis Neofitou Lucas and Visi Liki Lucas* v *New Zealand Insurance Co Ltd* (1983) 2 ANZ Insurance Cases #60,506; contrast the decision in *Amburla*.

[39] See *Leppard* v *Excess Insurance Co Ltd, supra*.

[40] See *Pleasurama Ltd* v *Sun Alliance and London Insurance Ltd, supra*.

[41] *Re Wilson and Scottish Insurance Corpn Ltd* [1920] 2 Ch 28; *Lake* v *Hartford Fire Insurance Co Ltd* [1966] WAR 161; *Dawson* v *Monarch Insurance Co of NZ Ltd* [1977] 1 NZLR 372, 377.

[42] *Rice* v *Baxendale* (1861) 7 H & N 96; *Dean* v *Thomas & Son* (1980) 1 ANZ Insurance Cases #60,402.

similar property be restored to his original position.[43] It is well established that nothing can be claimed in respect of mere sentimental value and a family heirloom, for example, will only attract its market value even though the owners may have felt that it was worth much more than that to them.[44] Unless the household effects insurance is on the basis of "new-for-old", the insured cannot expect new goods in replacement of those which are secondhand unless he makes some contribution towards the cost. In *Ewer* v *National Employers' Mutual General Insurance Association Ltd*[45] McKinnon J. expressed the matter thus:

> "Many an insured who has had an armchair burned to pieces has put forward the proposition: 'Well I want an armchair to sit upon. This one is destroyed and I can only get one to sit upon by buying a new one'. In some circumstances, if the law were otherwise, that might be very reasonable, but very often it is not recognised, and he realises to his chagrin that all he can recover is not an armchair to sit upon, but the reasonable value of the second-hand armchair that had been destroyed."

It is of course true that the insured, instead of contributing to the cost of a new article may be able to replace it with an equivalent second-hand article, in which case this will be the appropriate measure of indemnity.[46]

Where an article is damaged, rather than destroyed or lost, a measure based on market value is generally unfeasible, since the insured cannot go into the market and restore himself to his pre-loss position and a payment based on the difference in market value before and after loss may well not compensate the insured. Therefore, the *prima facie* measure of indemnity in the case of partial loss is the cost of repair, less allowance for betterment.[47]

(iii) *Stock in Trade*

Evaluation of the measure of indemnity is fraught with difficulty due to the fact that too often sight is lost of the point that in each case the appropriate measure of indemnity is that figure which will recompense *the insured* for the loss which he has sustained. There is no room here, as with buildings, for a sterile market value or reinstatement less depreciation rigid approach. Each case must be considered on its merits as the solution to the problem will depend on the nature and use of the stock in trade which has been destroyed or damaged. As James[48] points out "value"

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[43] However, where no market exists the cost of replacement is a material factor in considering value although it is not a substitute for the assessment of value. See *Dawson* v *Monarch Insurance Co of NZ Ltd, supra,* at 377-378; there was no market for an inflatable rabbit as there was only one in existence in New Zealand. See also the observations of Macfarlan J in *Roumeli Food Stores (NSW) Pty Ltd* v *New India Assurance Co Ltd* [1972] 1 NSWLR 227, 236.

[44] See *Ewer* v *National Employers Mutual General Insurance Association Ltd* (1937) 157 LT 16, 21; *Richard Aubrey Film Productions Ltd* v *Graham* [1960] 2 Lloyd's Rep. 101, 103.

[45] (1937) 157 LT 16.

[46] See James, "Indemnity Past and Present (2)", [1981] 9 The Adjusters Journal 10.

[47] See *Dawson v Monarch Insurance Co of NZ Ltd, supra,* 377-378; *Westminster Fire Office* v *Glasgow Provident Society* (1888) 13 App. Cas. 699.

[48] *Loc.cit.*, at 10; see footnote 46.

may mean quite different things to different people such as manufacturer, retailer or wholesaler. All that can be offered, therefore, are some guidelines.

First, it is clear that where plant and equipment used by an insured for the purpose of carrying on a business is destroyed the appropriate measure of indemnity would be the cost of replacement with new plant and equipment, less an allowance for depreciation; that is, the measure of indemnity must reflect the value of each article as part of a going concern.[49]

Second, for merchandise bought and sold by traders the measure of indemnity is the market value of the stock at the time and place of the loss.[50] If however there is no available market, the value of such merchandise is a question of fact which has to be determined upon a consideration of all the circumstances. The value of goods at a place where there is no market is, for ordinary purposes, ascertained by taking the price at the place of manufacture, together with the cost of carriage to the particular place and adding thereto a reasonable allowance for importers profit.[51] While it may be argued that any allowance for profit represents a consequential loss which should have been separately insured to be recoverable,[52] Welford and Otter-Barry[53] dismiss this argument because it disregards the fact that the question is the value of the goods at the place where they are destroyed — where there is a market the market price clearly includes the importers profit otherwise the goods would not have been imported and if, therefore, account is taken of such profit where there is a market, it must be taken into account in fixing a value where there is no market. A case which illustrates admirably the nature of the difficulties in assessing the amount recoverable in respect of stock losses in *Saunders and Co. Ltd* v *Phoenix Assurance Co. Ltd.*[54] The appellant insured certain merchandise and stock in trade against loss by fire with the respondent. The goods were destroyed by fire and a dispute arose as to the amount payable under the policy whereby the respondent agreed to pay "the value of the property at the time of the fire". The selling price of the insured stock, which had been imported from Europe, was limited under price control legislation to the landed cost plus a mark-up of a certain percentage. Between the receipt of the goods by the appellant and the date of the fire the price of the goods had increased substantially in the overseas countries in which they could be purchased. The Court of Appeal held that this circumstance did not entitle the insured to claim the higher cost of replacement; the appellant was entitled to recover the value to it of the property destroyed and there would be a complete indemnity through the reimbursement of the cost price

[49] See *Roumeli Food Stores (NSW) Pty Ltd* v *The New India Assurance Co Ltd, supra*; *Vance* v *Foster* (1841) Ir. Cir. Rep. 47.

[50] See Welford and Otter-Barry, *op.cit.*, 304; Sutton, *op.cit.*, 532; and the cases there cited.

[51] See *O'Hanlan* v *Great Western Rail Co* (1864) 34 LJQB 154; *Saunders and Co Ltd* v *Phoenix Assurance Co Ltd* [1953] NZLR 598, 605.

[52] See *Maurice* v *Goldsborough Mort & Co Ltd* [1939] AC 452, 461-463.

[53] *Op.cit.*, 304.

[54] [1953] NZLR 598.

coupled with a payment of the authorised profit. As Stanton J. who delivered the judgement of the Court, observed:

> ". . .(W)hen one asks what was the value of these goods to the appellant, can it doubted that the answer must be that they were worth what they had cost, plus the profit which the appellant could make by the sale of them. . .".[55]

Clearly this was correct for had the appellants received the replacement cost of merchandise destroyed in the fire they would have made a profit at the expense of the insurer; that is, if the fire had not occurred the appellant could not have received more for the goods than the landed cost plus authorised profit.

Finally, the question of indemnity in respect of the valuation of goods which are destroyed whilst in the possession and ownership of the manufacturer arises. It is submitted that, in the absence of any clear authority on this point,[56] the indemnity payable in respect of completed stock should be the market value of the merchandise destroyed. James[57] suggests that the proper measure of indemnity is "the replacement cost of purchases and the direct costs of production of completed stock" and states that no allowance should be made for profit in respect of completed stock. With respect, an indemnity on this basis would not be a full indemnity; the effect of the eventuality of the peril is that the manufacturer has lost more than simply the labour and materials used to produce the merchandise; he has lost an independent marketable commodity with a distinct value of its own. As Ivamy[58] argues

> "This is made clear where the insured in fact manufactures other goods and uses them to replace the goods destroyed. But for the fire, he would have had two sets of goods, each with its market value, whereas he has only one set, and, however the case is looked at he has lost the market value of the other."

Bearing in mind that the question must always be "What has the insured lost?", it is submitted that the measure of indemnity in respect of completed goods is the market value of such goods. In respect of goods destroyed in the course of manufacture an allowance must be made in addition to the cost of materials and production to represent the increase in value of the finished product,[59] and loss of raw materials may be assessed acording to the cost of replacement. Of course, very often the calculation of the appropriate measure of indemnity in respect of stock in trade is provided for specifically in the policy and the task facing the court is that of construing the policy — this may be no simple task as the judgement in *Mode Lainage Ltd* v *QBE Insurance Ltd*[60] reveals.

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[55] Ibid., at 606.

[56] See Welford and Otter-Barry, *op.cit.*, 304; Ivamy, *Fire and Motor Insurance* (3 ed, 1978) 171; and the cases there cited.

[57] *Loc.cit.*, 10.

[58] *Op.cit.*, 172.

[59] *Idem.*

[60] High Court, Auckland, 27 April 1983, A.984/80. Chilwell J likened the policy in question to the "reincarnation of the mythical Hydra" in that "as one cuts off heads they grow again" (at page 19). The judgment is 105 pages in length!

(d) *Account taken of things reducing loss*

As a corollary to the obligation of the insurer to pay only the loss the insured has sustained by reason of the occurrence of the contingency insured against, *account must be taken of all things tending to reduce that loss.* In *Burnand* v *Rodocanachi*[61] Lord Blackburn stated that in respect of a contract of indemnity "anything which reduces or diminishes that loss reduces or diminishes the amount which the indemnifier is bound to pay. . .".[62] This principle was applied in *Tees* v *Great American Insurance Co.*[63] where the owner of land and buildings that were insured against damage by fire granted an option to another to purchase the land and buildings. A fire occurred damaging the buildings, but the option was subsequently exercised and the owner received the full purchase price, the purchaser agreeing that the vendor should have the benefit of the insurance policy. In an action by the vendor against the insurer for the amount of the policy, it was held that the insured was not entitled to recover under the policy because he had already received a full indemnity from the purchaser by the payment of the agreed price.

However, it is not every payment received by the insured that may be taken into account by an insurer, in assessing the extent of an insured's loss. For example, in *Wollington* v *State Electricity Commission of Victoria*[64] the plaintiff sustained substantial property loss as a result of a bushfire caused by the defendant's negligence. In assessing the quantum of the defendant's liability, the court was asked to deduct payments made to the plaintiff by way of governmental relief. This the Supreme Court of Victoria declined to do, holding that in every case the ultimate test is the character of the payment, and payments made by governments for the relief of the destitute are charitable payments and not to be set off against damages payable by a third party. Therefore, as Sutton suggests,[65] it may be that the right of the insurer to have a payment brought into account in diminution of a loss is confined to that which is a right or other incident belonging to the insured, as an incident of the property insured at the time of the loss — thus excluding, for example, gifts and other *ex gratia* payments to the insured to assist him in the time of his misfortune.

(e) *Subject to the terms and conditions of the policy*

The liability of the insurers to pay the full amount of the loss may be limited by the terms and conditions of the policy. In particular, the following types of clauses may have a considerable inpact.

(i) *"Other insurance" clauses*

Insurers have sought to exclude, limit or qualify their liability by incorporating "other insurance" clauses in their standard form policies. These

[61] (1882) 7 App.Cas. 333; see also *Castellain* v *Preston* (1883) 11 QBD 380, 394.

[62] *Ibid*, at 339.

[63] (1972) 30 DLR (3d) 488.

[64] (1978) 1 ANZ Insurances cases #60,014.

[65] *Op.cit.*, at 529.

"other insurance" provisions take numerous and diverse forms but a typical clause would be one absolving an insurer from liability should other insurance covering the same risk be in existence or be effecting during the period of cover, unless the insurer is notified in writing of that other insurance.[66] Alternatively, the "other insurance" clause may endeavour to restrict the insurer's liability to the loss in excess of that covered by the other insurance.[67] A third permutation restricts the insurers liability to a rateable proportion of any sum payable in the event of any loss.[68] While such clauses are usually aimed at the situation where the insured has effected two policies against the same risk, namely at double insurance, these clauses need not necessarily be so limited; that is, they may be expressed as applying to any policy in existence or effected in relation *to any risk* or *to any property* covered by the instant policy. Therefore an insured would have to appraise each policy meticulously to ascertain whether the policy in contemplation covers a risk or item of property already insured in order to avoid the pitfall of such a provision. From the point of view of insurers a number of useful purposes are served by these "other insurance" clauses. Apart from the obvious advantage derived from extinguishing or limiting liability in respect of certain claims, they protect insurers from fraudulent over-insurance, facilitate the investigaton of claims, and enable the insurers to seek contributions where appropriate from one another. Where the clause is the so-called "rateable contribution clause" the insured is entitled only to a *pro rata* contribution from each insurer. As Stephenson LJ explained in *Commercial Union Assurance Co. Ltd* v *Hayden*[69]

> ". . .the introduction of a contribution clause into the insurer's policy prevents the assured from recovering full satisfaction from only one insurer, and if the other insurer repudiates liability or goes bankrupt or into liquidation, the assured may never recover full satisfaction."

This qualifies the insured's position for in the absence of such a rateable contribution clause the insured would be entitled to claim payment in full under either policy, leaving the insurer who makes payment to claim contribution from his co-insurers.[70]

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[66] See *Steadfast Insurance Co Ltd* v *F & B Trading Co Ltd* (1971) 125 CLR 578; *Deaves* v *CML Fire and General Insurance Co Ltd* (1979) 53 ALJR 382; *National Employers Mutual General Insurance Association Ltd* v *Hayden* [1979] 2 Lloyd's Rep. 235; *Boys* v *State Insurance General Manager* [1980] 1 NZLR 87, 91-92.

[67] See *State Fire Insurance General Manager* v *Liverpool & London & Globe Insurance Co Ltd* [1952] NZLR 5; *Wawanesa Mutual Insurance Co* v *Cooperative Fire and Casualty Co* (1981) 119 DLR (3d) 188; *South British Insurance Co Ltd* v *Norwich Winterthur Insurance (NZ) Ltd* (1983) 2 ANZ Insurance Cases #60,499.

[68] See *North British & Mercantile Insurance Co* v *London, Liverpool & Globe Insurance Co* (1877) 5 Ch D 569; *Commercial Union Assurance Co Ltd* v *Hayden*, *supra*.

[69] *Supra*, at 450.

[70] For a discussion of double insurance, contribution and "other insurance" clauses, see Tarr [1982] NZLJ 136.

(ii) *Excess and average clauses*

Other important types of clauses qualifying or limiting the amount recoverable from an insurer under a policy, are "excess" or "average" clauses. Excess clauses usually are found in household effects and motor vehicle policies under which the insured must accept liability for a specified amount of loss, for example, the first $60. The effect is to relieve the insurer of liability in respect of minor losses up to a stated figure, and to render him liable only over that amount. Excess clauses are mutually advantageous to insurer and insured; the insurer is able to avoid the administrative expenses associated with the processing of small claims and the insured gets the benefit of lower premiums. "Average" clauses, long common in policies of marine insurance, are becoming increasingly popular for all types of insurance.[71] Under an average clause an insured will be entitled to the full sum insured only if he has sustained a total loss. Where his loss is partial and he has not insured for the full value, the insured is deemed to be his own insurer for the difference in value and must bear a rateable proportion of the loss accordingly.[72] For example, suppose the insured owns property worth $50,000 but takes out cover of $30,000. If the property is partially destroyed and the insured sustains a loss of $20,000 and the policy is subject to average, the insured is only entitled to recover $12,000. The drastic consequences to an insured where a policy is "subject to average" has prompted the Contracts and Commercial Law Reform Committee to advocate the curtailment of the use of these clauses; namely, the Committee have proposed that average clauses be of no effect in contracts relating to dwelling houses or the contents thereof, and that in all other contracts of insurance such provisions be of no effect unless the contract contains a conspicuous statement as to the existence and effect of any average clause in the policy.[73]

However, at the present time, average clauses and clauses of the "other insurance" and "excess" variety may have a significant impact on the amount recoverable under any policy and for this reason a careful appraisal

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[71] For example, in *Carreras* v *Cunard Steamship Co Ltd* [1918] 1 KB 118 it was held that an average clause was now so common in a fire policy on goods warehoused by a commercial firm that such a clause must be implied into the defendant's insurance contract. See Sutton, *op.cit.*, 543; *Steadfast Insurance Co Ltd* v *F & B Trading Co Pty Ltd, supra.*

[72] The following formula is used to compute the loss; namely,

$$\frac{\text{Policy Value}}{\text{Value of the Subject Matter}} \times \text{Amount of Loss}$$

The standard justification for employing average clauses is that an insured, relying on efficient fire services, will have, in the absence of such a provision, total protection for the overwhelming number of fire losses. Very rarely will damage amounting to the total value of the property be sustained with the consequence that under insurance (in terms of total value) will more often than not cover the extent of the loss. Average clauses force the insured to bear a rateable proportion of such under insurance. For a criticism of such clauses, see Thomas, *op.cit.*, 212.

[73] See the Draft Insurance Law Reform Bill, clause 13; the Bill is produced as Appendix A in the Contracts and Commercial Law Reform Committee's Report, *Aspects of Insurance Law* (2), 19 May 1983.

of *all* the terms and conditions of a policy is a vital part of any assessment process.

(f) *Interest*

Finally, it should be borne in mind that an insured who sues on a contract of insurance may be entitled to claim interest under the provisions of section 87 of the Judicature Act 1908. The principle underlying the statutory discretion to award interest is that "a successful plaintiff should be compensated for the loss involved in being kept out of his money by an unsuccessful defendant".[74]

(3) *Conclusion*

The following observations are advanced by way of conclusion to this article.

(a) It is submitted that the boundaries of insurable interest should be more widely drawn in order "to protect men against uncertain events which may in anywise be of disadvantage to them. . .".[75] By formulating a test of insurable interest based on a broadly conceived factual expectancy of advantage from the non-occurrence of the event insured against, or, conversely, factual expectancy of loss from its occurrence, more flexibility would be arrogated to both public and insurers alike.[76] It is suggested that the Australian Law Reform Commission recommendation that the insurer should not be relieved of liability by reason only that the insured did not have a legal or equitable interest in the property should be implemented in New Zealand.[77] There seems to be no good reason why an insured who has been economically disadvantaged by damage or destruction to insured property should be denied liability on the basis that he did not stand in some legally recognised relationship to the property;[78] public policy arguments relating to the necessity to avoid the promotion of gambling and of inducing the destruction of property for profit ring hollow in times of extensive legalised gambling on horse races and elsewhere, and in the light of sophisticated investigations undertaken by the police, loss adjusters and others into the cause of fires, etc. In any event it is always open to an insurer to decline the acceptance of a risk where the proponent does not have a legal or equitable interest in the property which he wishes to insure.

(b) As regards the appropriate measure of indemnity it must always be borne in mind that the policy insures the insured's loss and account therefore, must be taken of his intention in relation to the subject matter of

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[74] Per Mahon J in *Blackley* v *National Mutual Life Association of Australasia Ltd* (No. 2) [1973] 1 NZLR 668, 671; see also *Mode Lainage Ltd* v *QBE Insurance Ltd, supra*, at 17.

[75] See *Lucena* v *Crauford*, 127 ER 630, 642; per Lawrence J.

[76] See Keeton, *Insurance Law* (1971), 98-100.

[77] See *Report on Insurance Contracts* (1982), para 120.

[78] For example, refer to cases such as *Macaura* v *Northern Assurance Co, supra*; *Mollinson* v *Victoria Insurance Co Ltd* (1883) NZLR 2 SC 177; *United Insurance Co Ltd* v *Black* [1940] NZLR 377.

insurance; if the insured proposes to demolish a building, for example, he will be making a profit at the expense of the insurer if he is paid the market value at the time of its destruction, and to suggest that no account may be taken of the insured's subjective intentions at the time of the loss runs counter to the very principle of indemnity.

(c) The current employment of average clauses in householder's and houseowner's policies is most unsatisfactory. These clauses, which had their genesis in commercial contracts of marine insurance, may greatly affect persons who are underinsured and it is submitted that their use should be regulated. The Contracts and Commercial Law Reform Committee advocate that they should be ineffective in any "contract of insurance relating to a dwelling house or any of the contents thereof".[79] As an alternative and less draconian solution, the legislature could require as a prerequisite for the enforceability of such a clause, that the policy in question contain a conspicuous statement as to the existence and effect of the clause.[80] Given that the underlying dissatisfaction with average clauses is that many, if not the overwhelming majority, of the public do not appreciate or understand the significance of such provisions, mandatory disclosure of the existence and attributes of these clauses will defuse the basis of complaint.[81] As with the Hire Purchase Act 1971 which permits a vendor to exclude the implication of the statutory terms as to merchantable quality and fitness for purpose where the agreement contains a conspicuous statement to that effect,[82] so too could average clauses be enforced where the insurer has in a conspicuous statement drawn the insured's attention to the provision. It is submitted that this solution is preferable to the one which would simply deny such clauses any effect in "house and contents" policies, as a blanket bar to the enforceability of such provisions may lead to insurance companies raising their premiums across the board to cover the potential additional liability; that is, the costs to the general body of insureds may outweigh the benefits which would accrue to those individuals who are underinsured. This latter category of persons could be assisted by a mandatory disclosure provision — there would be no need to preclude an insurance company from relying on an average clause which is both conspicuous and explained in understandable terms.

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[79] Draft Insurance Law Reform Bill, clause 13(1); see footnote 73, *supra*.

[80] The Contracts and Commercial Law Reform Committee advocate this approach as regards other contracts of insurance; that is, contracts other than those of marine insurance or of the houseowners and contents variety. See the Draft Bill, clause 13(2).

[81] Cayne and Trebilcock, "Market Considerations and Consumer Protection Policy", (1973) 23 University of Toronto Law Journal 396, 406 comment that ". . .inability to utilise information will always subvert a disclosure requirement. The educational inadequacies associated with poverty are relevant in this context". However, this writer respectfully concurs with Atiyah, "Consumer Protection—Time to Take Stock", (1979) 1 Liverpool Law Review 20, 44, when that learned writer asserts that ". . .it is not necessarily the best policy to frame our consumer protection laws on the basis of the maxim, *lex procurator fatuorum est*. . .".

[82] See the Hire Purchase Act 1971, ss.12(1)(a), (d); 13(1)(a). In *Terminus Car Court Ltd* v *Lewis* [1975] 1 NZLR 260, 262, Casey J held that "conspicuous" meant ". . . clearly visible, obvious, or striking to the eye of somebody who simply scans through the agreement".

(d) The cases discussed above reveal the difficulties inherent in ascertaining the proper measure of indemnity under property insurance policies. These difficulties stem in the main from a recognition that the measure of indemnity is different amounts to different people, that it is liable to vary according to the insured's use and intentions in respect of the insured property and that it is not necessarily the value of the subject matter destroyed or damaged by the realisation of the peril. However, the general principle applicable has never been in dispute. As Brett LJ observed in the famous case of *Castellain* v *Preston*:[83]

> "The very foundation. . .of every rule which has been applied to insurance law is this, namely that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, because of a loss against which the policy has been made, shall be fully indemnified but shall never be more than fully indemnified."

[83] (1883) 11 QBD 380, 386.