Prevention of Performance in Replacement Cost Insurance — Preventing a Fictional Response

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I: Introduction

An insured who purchases a "replacement cost" insurance policy pays a premium that is higher than that paid for an ordinary indemnity insurance policy. In return for the higher premium the insurer promises to provide an improved benefit. The insurer's promise is to pay the full cost of replacing any of the insured's damaged property, whereas under an ordinary indemnity policy the insurer's payment would be lower, reflecting the depreciated value of the property prior to damage. The policy will make payment of this improved benefit conditional on the insured doing two things: (1) actually incurring the costs of replacement, and (2) commencing and carrying out replacement with reasonable despatch. If those conditions are not fulfilled the insured's recovery is limited to an ordinary indemnity.

If the insurer wrongfully declines an insured's claim the improved benefit provided by a replacement cost policy can soon become illusory. Without an acceptance from the insurer, most insureds find it difficult to fulfil the two conditions. The insured may then find that, even once a court has found the insurer's declinature to be wrongful, the insurer will argue that it should pay only an ordinary indemnity. The insurer's argument will be that, since the conditions were never fulfilled, the insured can recover only an ordinary indemnity, and not full replacement cost.

The purpose of this paper is to assess the validity of the insurer's argument. The argument is one that will strike many as immediately unappealing, since it allows the insurer to take advantage of its own wrong. That intuitive opposition can manifest itself through at least two legal explanations: that the insurer should be estopped from relying on the insured's failure to fulfil the conditions, or that the insurer is itself in breach of an implied obligation not to prevent the insured from fulfilling the conditions. Many courts have rejected the insurer's argument, but without a convincing or consistent explanation. Moreover, in the leading judgment on point, the High Court of Australia upheld the insurer's argument.[1]

We assess the insurer's argument against orthodox contract law doctrine and explain why the argument should be rejected. We argue that the explanation differs according to the remedy sought by the insured, and that the relevant explanations are surprisingly simple. Where the insured seeks a declaratory remedy, the explanation is found within the principles applied to the construction

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1 *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384.

of contracts. Where the insured seeks a remedy in damages, the explanation is found within the causation principle: that a party who breaches a contract is, subject to questions of remoteness, liable for all losses caused by the breach.

II: The Contractual Setting

A replacement cost insurance policy is a form of property insurance, under which the insurer promises to indemnify the insured against loss of or damage to the property. The insured property may be real or personal, though throughout this paper we assume that we are dealing with insurance over real property.[2]

A fundamental principle of insurance law is that, under a contract of indemnity insurance, the insured may not recover more than an indemnity.[3] The "indemnity principle" means that the insured's recovery is limited to an amount sufficient to restore the insured to his or her pre-loss position. The appropriate measure of the insured's recovery depends upon the particular circumstances of the insured. One possible measure is the fall in the property's market value. Market value is an appropriate measure where the insured was, at the time of the loss, intending to sell the property.[4] However, most insureds own real property for the purpose of ongoing use as a home or place of business, rather than for the purpose of realising the property's value by sale. Such insureds can be restored to their pre-loss position only by reinstating (rebuilding or repairing) their property. For most insureds, therefore, the appropriate measure of indemnity is the cost of reinstating their lost or damaged property.[5]

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2 There is no difference in the legal principles applied to insurances over real or personal property. There is, however, a practical difference in relation to replacement cost insurance. Because of the generally lower value of personal property, a wrongful declinature is less likely to inhibit an insured in replacing personal property than in replacing real property. For cases involving replacement cost insurance over personal property, see *Donald A Foley Ltd v Canadian Indemnity Co* (1982) 137 DLR (3d) 274 (Ont HCJ); *BSF Inc v Cason* 333 SE2d 154 (Ga Ct App, 1985); *State Farm Fire & Casualty Insurance Co v Miceli* 518 NE2d 357 (Ill App Ct, 1987); *Ferguson v Lakeland Mutual Insurance Co* 596 A2d 883 (Pa Super Ct, 1991); *Bratcher v State Farm Fire & Casualty Co* 961 P2d 828 (Okla, 1998).

3 *Castellain v Preston* (1883) 11 QBD 380, 386. The principle can be explained either as a matter of presumed contractual intention (this is what the parties meant by "indemnity") or as a matter of broad policy (the law should not allow insurance contracts to be used as a means of improving the insured's position). The former seems to be the better explanation for Commonwealth jurisdictions, in which the parties are, as we will see in relation to replacement cost insurance, generally free to contract out of the indemnity principle (but see *British Traders' Insurance Co Ltd v Monson* (1964) 111 CLR 86, 94, where the High Court of Australia stated that underlying the indemnity principle was "the law's policy not to allow gambling in the form of insurance").

4 *E.g., Leppard v Excess Insurance Co Ltd* [1979] 1 WLR 512 (CA).

5 *Lucas v New Zealand Insurance Co Ltd* [1983] VR 698; *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440. At this point it is necessary to avoid a terminological difficulty that can arise from the different senses in which "reinstatement" can be used in relation to property insurance. Reinstatement may refer to a *method* by which the insurer discharges its obligation, or to a *measure* of the insurer's obligation. In the former sense, the insurer is given the option to discharge its obligation by reinstating (repairing or rebuilding) the property either by itself or

Where the cost of reinstatement is used as the measure of indemnity, an amount known as "betterment" must be deducted from that cost to determine finally the amount payable by the insurer.[6] Betterment is the amount by which the reinstated property (containing new materials) is more useful or valuable than the pre-loss property (containing old materials). A deduction for betterment is a necessary corollary of the indemnity principle: the deduction ensures that an insured is not put in a better position, post-indemnity, than he or she was in prior to the loss.

A deduction for betterment means that if the insured wishes to reinstate the property with materials of the same kind and quality, he or she will have to contribute part of the cost of reinstatement. If the insured lacks the funds to make this contribution, he or she is forced either to reinstate with inferior materials or to sell the property in its damaged state for a lesser value. This inadequacy of ordinary indemnity insurance led to the development of "replacement cost" insurance. Replacement cost insurance allows recovery on a "new-for-old" basis: the insured can recover the full cost of reinstatement without any deduction for betterment. Replacement cost insurance usually appears as an optional endorsement to the indemnity policy. We will call the amount payable under a replacement cost policy "full replacement cost". By contrast, we will use the term "ordinary indemnity" to refer to the amount payable under an ordinary indemnity policy (cost of reinstatement, less betterment).

Replacement cost insurance enables the insured to recover more than an indemnity, and is thus an example of the parties contracting out of the indemnity principle.[7] However, the peculiar nature of this insurance means that recovery of full replacement cost is commonly subject to various conditions, two of which are the concern of this paper. First, since the insured can recover more than an indemnity, there is the possibility that the occurrence of loss or damage might improve the insured's position. This possibility increases the risk that the loss or damage will occur, because the insured has a reduced incentive to take precautions to prevent damage to the property, and even some incentive actually

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by contracting a builder. The alternative method is for the insurer to discharge its obligation by paying a sum of money to the insured. If the insurer does choose to pay a sum of money to the insured, then reinstatement is sometimes used in the second sense as a measure quantifying the amount of money payable. Once the insurer has paid the insured, the insured is free to spend the money however he or she likes: the insured is under no obligation to use the money to reinstate the property (*Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440, 462; *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, 396). Reinstatement as a method of indemnity does not give rise to the issues discussed in this paper, because it occurs only where the insurer has first accepted the insured's claim.

6 *Reynolds v Phoenix Assurance Co Ltd, ibid.; Roumeli Food Stores (NSW) Pty Ltd v The New India Assurance Co Ltd* (1972) 1 NSWLR 227; *Vintix Pty Ltd v Lumley General Insurance Ltd* (1991) 6 ANZ Insurance Cases ¶61-050.

7 In the United States, because the indemnity principle is regarded as a matter of public policy, the issuance of reinstatement policies required legislative approval. See Jordan, "What Price Rebuilding? A Look at Replacement Cost Policies" (1990) 19 *The Brief* 17 at note 19. In Commonwealth jurisdictions the indemnity principle operates as a rule of presumed contractual intention, so the parties are free to contract out of the rule.

to facilitate the damage. This is known as increased moral hazard.[8] Insurers counter the increased moral hazard by requiring that the insured actually incur the costs of reinstating the property. This first condition curtails moral hazard by restricting the purposes to which the insured may apply the proceeds of the policy. By comparison, under an ordinary indemnity policy the insured is free to apply the insurance proceeds to any purpose, even when those proceeds have been measured by the cost of reinstatement.[9]

A second condition commonly placed upon recovery of full replacement cost is that the insured carry out the reinstatement with reasonable despatch. This condition is intended to insulate the insurer against the risk of increased building costs, whether due to new building codes or to inflation.

In summary, a replacement cost policy will usually make the insurer's obligation to pay the full replacement cost conditional upon the insured (1) actually incurring the costs of reinstatement, and (2) commencing and carrying out reinstatement with reasonable despatch. The stated conditions are merely contingent, as opposed to promissory, so an insured is not under an *obligation* to fulfil them. Pending fulfilment of the conditions by the insured, the insurer's obligation to pay full replacement cost does not arise,[10] but is limited to paying an ordinary indemnity.

It is apparent that for an insured with replacement cost insurance to fulfil the conditions he or she must have access to sufficient funds to meet the costs of rebuilding. When the insurer admits liability for a claim, obtaining funds is typically an uncomplicated process. Indeed, the usual practice of insurers is to make payment directly to the person who has been engaged to rebuild. If, however, the insurer wrongfully denies liability, the insured may be unable or unwilling to finance the cost of rebuilding. For an insured without sufficient financial resources (most homeowners, for example) the denial of liability will make it considerably more difficult and often practically impossible to finance rebuilding.[11] In many cases the insured's need to find habitable accommodation

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8 Moral hazard is that part of the risk referable to the personal situation of the insured, as opposed to the state of the property. Fear of increased moral hazard meant that when reinstatement coverage first became available in the United States, it was initially offered only to the likes of public utilities, school boards, government organisations and large manufacturers, risks with seemingly low moral hazard. See Jordan, "What Price Rebuilding? A Look at Replacement Cost Policies" (1990) 19 *The Brief* 17 at 18.

9 *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440, 462; *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, 396.

10 It should be noted that the conditions may be worded differently in individual policies and that the *contra proferentem* rule requires any ambiguities to be resolved against the party drafting them, normally the insurer. In several American cases, ambiguous drafting led to a finding that the insured was not required to fulfil the conditions, or that the conditions were conditions subsequent so that the obligation they imposed on the insured did not arise until *after* the insurer paid reinstatement moneys. See, *e.g.*: *Reese v Northern Insurance Co of New York* 215 A2d 266 (Penn Super Ct, 1965); *National Fire Insurance Co of Hartford v Solomon* 638 P2d 1259 (Wash, 1982); *Sayes v Safeco Insurance Co of America* 567 So2d 687 (La Ct App, 1990).

11 In *CIC Insurance Ltd v Bankstown Football Club Ltd* (1995) 8 ANZ Insurance Cases ¶61-232, 75,564 (NSWCA), Kirby P stated that the condition does not require the

or premises while pursuing litigation forces the insured to sell the unrepaired property, after which it is impossible to fulfil the conditions.[12] Even where the insured has sufficient financial resources to rebuild, commercial considerations may mean that the insured is unwilling to proceed without an admission or finding of liability.[13]

In summary, where the insurer wrongfully declines a claim it remains open to the insured to rebuild with reasonable despatch, prove the claim in court, and then recover full replacement cost. If, however, the insured is unable or unwilling to rebuild, the conditions will not be fulfilled. Thus, even where the insured succeeds in proving the claim in court, the non-fulfilment of the conditions allows the insurer to argue that its obligation to pay full replacement cost has not arisen, so that its obligation is limited to paying an ordinary indemnity.

The validity of the insurer's argument can be properly assessed only by relating the argument to the specific remedies available to the insured. In our view courts have often failed to do this. Thus, before considering specific responses to the insurer's argument in Parts IV and V, we outline in the next Part the remedies available to an insured whose claim has been wrongfully declined, and for whom rebuilding is either impractical or unfeasible.

III: The Insured's Remedies

An insurer's obligation under a contract of indemnity insurance is to admit liability for any valid claim and to indemnify the insured within a reasonable time of receiving the claim.[14] Thus, an insurer's wrongful declinature is a breach of contract, with two consequences. First, it imposes on the insurer a substituted secondary obligation to pay damages in respect of any loss or damage sustained by the insured from the breach. Secondly, because the breach has the effect of depriving the insured of substantially the whole benefit of the contract, it is a repudiatory breach, the effect of which is to give the insured the election of either affirming or terminating the contract.

If the insured affirms the contract both parties remain bound by and entitled to the benefit of the contract. This does not preclude the insured from seeking, in respect of the breach, a remedy in damages or a declaration.

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insured actually to pay over the money to those reinstating the property. Instead, it would be sufficient for the insured to incur the obligation to pay the money. This distinction is somewhat illusory, for few builders would be willing to reinstate if the insured could not provide payment, some form of security, or a proven entitlement to reinstatement monies.

12 In the following cases, the court found that the sale of the unrepaired property was brought about by the insurer's wrongful declinature: *Bland v South British Insurance Co Ltd* (1990) 6 ANZ Insurance Cases ¶60-998; *Kerr v The State Insurance General Manager* (1987) 4 ANZ Insurance Cases ¶60-781; *Edwards v AA Mutual Insurance Co* (1985) 3 ANZ Insurance Cases ¶60-668.

13 Eg, *City Realties (Holdings) Ltd v National Insurance Co of New Zealand Ltd* (1986) 4 ANZ Insurance Cases ¶60-695.

14 *New Zealand Insurance Co Ltd v Harris* [1990] 1 NZLR 10 (CA); *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384, 400–401.

Under any insurance policy the insured may seek a declaration that the insurer is liable to indemnify for a particular loss.[15] Under a replacement cost policy an insured who has affirmed the contract should be able to seek a further declaration in these terms: that, as and when the insured incurs the costs of rebuilding, he or she is entitled to be reimbursed fully by the insurer.[16] Any reputable insurer will, once such a declaration is made, pay the insured's claim in the normal way. However, it is open to the insurer to argue that the declaration should not be made unless and until the insured has fulfilled the conditions. We examine the strength of the insurer's argument below, in Part IV.

For the insured who has affirmed, an alternative remedy is damages for breach of contract. A claim for damages could be brought in respect of either the insurer's obligation to pay full replacement cost, or the insurer's obligation to pay an ordinary indemnity.[17] The former claim would properly be met by the insurer's argument that, because of the insured's non-fulfilment of the conditions, the replacement cost obligation had not arisen; in other words, that the insurer's breach of that obligation was merely anticipatory. A person who affirms a contract cannot recover damages in respect of an anticipatory, as opposed to an actual, breach.[18]

The position is different, however, where the insured's claim for damages is in respect of the insurer's obligation to admit liability and pay an ordinary indemnity. This claim for damages will encompass not only the direct loss suffered by the insured in not receiving the indemnity, but also any consequential losses suffered therefrom. As we will explain in Part V, the insured may be able to prove that one such consequential loss was that he or she was deprived of the opportunity to fulfil the conditions precedent to recovery of full replacement cost. By this means the insured may be able indirectly to recover full replacement cost as a *consequence* of the insurer's breach of the obligation to admit liability and pay an ordinary indemnity.

Rather than affirm the contract, the insured may terminate it. Upon termination the parties are discharged from further performance of the contract.[19] The insured

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15 See *Countrywide Finance Ltd v State Insurance Ltd* [1993] 3 NZLR 745, 749–753.

16 In several cases courts have made a declaration to that effect. See, *e.g.*: *Cannell v Commercial Union Insurance Co Ltd* (1985) 3 ANZ Insurance Cases ¶60-666; *City Realties (Holdings) Ltd v National Insurance Co of New Zealand Ltd* (1986) 4 ANZ Insurance Cases ¶60-695; *Datatech Systems Ltd v Commonwealth Insurance Co* (1983) 149 DLR (3d) 376 (BCCA); *Tamco Corporation v Federal Insurance Co of New York* 216 FSupp. 767 (ND Ill, 1963).

17 The insured, whether affirming or terminating, might make an additional claim alleging breach by the insurer of the duty of good faith. However, where there is a clear breach by the insurer of an express obligation, it is difficult to see what the good faith claim would add. A good faith claim might add something if the insured wished to claim exemplary damages (this was the spur for the development, in the United States, of bad faith litigation against insurers). In this paper we are concerned only with the insured's claim for compensatory damages.

18 See *Ogle v Comboyuro Investments Pty Ltd* (1976) 136 CLR 444, 450.

19 We are not aware of any cases in which an insured has terminated the contract and claimed damages in respect of the replacement cost obligation. The lack of case law is probably due to the insured's reluctance to terminate. There may be various reasons for this reluctance. The insured may think that termination will

may then claim damages from the insurer. Because the contract was terminated on the ground of the insurer's repudiatory breach, the insured may claim damages for the non-performance of the insurer's future as well as accrued obligations.[20] The insured is, therefore, not limited to claiming damages merely in respect of the insurer's failure to pay an ordinary indemnity (which, at the time of termination, was an accrued obligation of the insurer). The insured may claim damages also in respect of the insurer's failure to pay full replacement cost (which, at the time of termination, was a future obligation).[21] However, the insured's entitlement to damages in respect of the replacement cost obligation is dependent upon being able to show that he or she was ready, willing, and able to fulfil the conditions precedent to that obligation.[22] The insurer is likely to argue that, because the insured did not have sufficient finances to rebuild, the insured lacked the *ability* to fulfil the conditions precedent. The intuitive response to the insurer's argument is that, given that the insurer's wrongful declinature contributed to the insured's financial difficulty, this is not an argument that should be open to the insurer. We explore different ways of articulating that response in Part V.

In summary, the insured whose claim has been wrongfully declined by the insurer has three options: (1) affirm the contract and seek a declaration; (2) affirm the contract and claim damages; or (3) terminate the contract and claim damages. In response to any of these the insurer may argue that the insured has not fulfilled, or was not ready, willing, and able to fulfil, the conditions precedent to recovery of full replacement cost. In the following two Parts we assess the insurer's argument, first in relation to a declaratory remedy, and secondly in relation to damages.

IV: Declaration

A declaration commonly sought by an insured is that, as and when the insured incurs the costs of rebuilding, he or she is entitled to be reimbursed fully by the insurer. How effectual is it for the insurer to argue in response that the insured has not fulfilled the conditions precedent to recovery of full replacement cost?

In relation to the first condition (the requirement to incur rebuilding costs) the answer is, in our view, simple. The declaration, by providing that the insured's entitlement to full replacement costs is conditional on the insured incurring rebuilding costs, incorporates that condition. The declaration will thus be of no use to the insured unless the condition is fulfilled. The form of the declaration therefore answers the insurer's argument.

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jeopardise negotiations with the insurer, or the insured may have other property covered by the policy for which ongoing cover is desired.

20 *Frost v Knight* (1872) LR 7 Ex 111, 113; *Photo Productions Ltd v Securicor Transport Ltd* [1980] AC 827, 849; *Morris v Robert Jones Investments Ltd* [1994] 2 NZLR 275.

21 Comments made in *CIC Insurance Ltd v Bankstown Football Club Ltd* by the New South Wales Court of Appeal (1995) 8 ANZ Insurance Cases ¶61-232, 75,564, and by the majority of the High Court (1997) 187 CLR 384, 403, suggest that on termination replacement cost monies are recoverable as damages.

22 *Foran v Wight* (1989) 168 CLR 385, 430–431, 438–439.

It is more to the point for the insurer to argue that, by the time the matter arrives in court, it is too late for the insured to comply with the second, temporal, condition (rebuilding to commence with reasonable despatch). The insurer's argument on this point needs to be assessed on two levels. The first is whether, on a proper interpretation of the contract, the insured can no longer comply with the temporal condition. The second is whether, even if it is too late for the insured to comply, the non-compliance can be excused in a way that allows the declaration to be made.

On the first level, the temporal condition usually requires simply that the insured carry out rebuilding "with reasonable despatch". The interpretative issue here is the standard by which reasonableness should be measured. The term "reasonable" requires, of course, an objective standard. The question is whether reasonableness should take account of the insured's claim having been declined. This question is crucial for an insured seeking a declaration, because litigation determining liability will invariably exceed the period of reasonable despatch if that period is measured from the standpoint of an insured whose claim has been accepted.[23]

There are several reasons for thinking that account should be taken of the insurer's declinature. First, our suggestion here is that reasonableness should take into account the insurer's response to the claim, whatever that response is (acceptance or declinature). Once the matter is stated in that way, it becomes clear that the only viable alternative to taking account of the insurer's response is to assess reasonableness from the standpoint of an insured whose claim has been accepted. Secondly, that alternative is excluded by the rule that a condition should not be construed in a way repugnant to the commercial purpose of the contract.[24] It is repugnant because it means that replacement cost insurance is of practical benefit to the insured only where the insurer admits liability. To put it another way, a construction that assesses reasonableness from the standpoint of an insured whose claim has been accepted is unlikely to reflect the parties' intentions, because it allows the insurer to take advantage of its own wrong.[25] Thirdly, in the context of the "reasonable care" condition commonly found in insurance policies it has been said that what matters is what is reasonable as between the insured and the insurer.[26] It is not reasonable, as between the insured and the insurer, to expect the insured to rebuild when the insurer's wrongful declinature has meant that the insured has no access to insurance monies to finance rebuilding.

Our view has mixed judicial support. In New Zealand the insurer's wrongful declinature has, in an obiter passage, been regarded as relevant to reasonable despatch.[27] In British Columbia it has been held that for so long as the insurer

23 A survey of American cases revealed that the reasonable time period covered periods ranging from ten months to one year: Koenders, *Annotation*, Construction and Effect of Property Insurance Provision Permitting Recovery of Replacement Cost of Property 1 ALR 5th 817 (1999) ¶10.

24 *Fraser v B N Furman (Productions) Ltd* [1967] 1 WLR 898, 905 (CA).

25 *Cheall v Association of Professional Executive Clerical and Computer Staff* [1983] 2 AC 180, 188–189. See Lewison, *The Interpretation of Contracts* (2nd ed, 1997) 6.08.

26 *Fraser v B N Furman (Productions) Ltd* [1967] 1 WLR 898 (CA).

27 *City Realties (Holdings) Ltd v National Insurance Co of New Zealand Ltd* (1986) 4 ANZ

wrongfully declines the claim it is not reasonable to expect the insured to rebuild.[28] The clearest support for our view is found in a judgment of Gaudron J, in the High Court of Australia, in *CIC Insurance Ltd v Bankstown Football Club Ltd*:[29]

> It is not reasonable, in my view, to require an insured person to commence and carry out rebuilding and repairs in circumstances where the insurer is wrongfully denying liability under a policy of insurance of the kind involved in this case.

In this view, however, Gaudron J was in the minority. The majority, without any analysis of the matter, simply assumed that "reasonable despatch" should be measured without any consideration of the insurer's wrongful declinature.[30]

If our view as to the construction of a "reasonable despatch" condition is correct, an insurer will be unable to argue that the insured can no longer fulfil the condition. However, this view will be of no assistance to an insured in two cases. The first is where the temporal condition is expressed by reference to a specific period. For example, it is common in North American policies for the condition to require rebuilding to commence within 180 days of loss. Where a rebuilding period is specified in this manner, the insured will be unable to fulfil the condition (unless litigation has proceeded very quickly). The second and all too frequent case is where practicalities have forced the insured to sell the property in its unrepaired state.[31] The insured will then be unable to fulfil either condition precedent.

In those two cases a declaratory remedy will be unavailable, unless the insured can rely on some exculpatory doctrine to *excuse* the non-fulfilment of the condition. We will see in the next Part that some courts have applied such exculpatory doctrines in relation to claims for damages. However, we will argue that those doctrines have been misapplied in the context of replacement cost policies, and that to excuse non-fulfilment is to engage in a problematic fiction. Application of the exculpatory doctrines is equally problematic in relation to a claim for a declaration. In the two cases just mentioned, therefore, the non-fulfilment of conditions cannot be excused, and a declaration will be unavailable. The insured will be left to a remedy in damages, which remedy we now explore.

V: Damages

We saw earlier that when the insured sues for damages the insurer commonly argues that damages are not available on a replacement cost basis because the insured has not fulfilled the conditions, or has not shown that he or she was ready, willing, and able to do so. However, in these cases the non-fulfilment is

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Insurance Cases ¶60-695, 74,140.

28 *Omega Inn Ltd v Continental Insurance Co* (1987) 37 DLR (4th) 573, 574.

29 (1997) 187 CLR 384, 412. Gaudron J nonetheless refused to grant a declaration on the ground that the insured had not fulfilled the other condition (incurring rebuilding costs). It is unclear why her Honour felt unable to grant a declaration that was subject to this condition.

30 *Ibid.*, 403.

31 See text, above at note 12.

arguably a result of the insurer's wrongful declinature. The unfairness of the insurer's argument is apparent:[32]

> The defendant's construction permits the insurer, in some circumstances, by its own act of denying coverage, to decrease the amount of its potential liability under an endorsement the purpose of which is to increase that potential liability. If the insured is not financially strong enough to effect replacement through his own resources, he does not have the benefit of the increased coverage for which he paid.

In this passage the unfairness of the insurer's argument is grounded on the principle that a person should not be able to take advantage of his or her own wrong. This principle is, however, a too broadly articulated ground on which to reject the insurer's argument. In this Part we examine how the unfairness, and that principle, can be more aptly expressed through orthodox legal doctrines.

In determining what doctrines might explain the unfairness of the insurer's argument, we begin by contrasting the position of an insured who has terminated with an insured who has affirmed. Upon termination an insured can recover damages in respect of the replacement cost obligation, subject to showing readiness, willingness, and ability to fulfil the conditions precedent. By contrast, an insured who affirms is limited in its damages remedy to a suit in respect of the insurer's obligation to pay an ordinary indemnity. This suggests that an insured who has terminated is in a better position than one who has affirmed. This was the implication of the High Court of Australia's decision in *CIC Insurance Ltd v Bankstown Football Club Ltd*.[33]

In that case, the insured's premises were damaged by fire. The relevant policy entitled the insured either to claim the indemnity value of the property at the time of loss, or to claim the replacement cost of the property. A further clause required the insured to commence and carry out replacement with reasonable despatch, failing which the insurer was not liable to make any payment greater than the indemnity value. The insured lodged its claim on the day after the fire, electing to receive replacement cost. Six months later the insurer wrote to the insured alleging that the claim was fraudulent and stating that the insurer had decided to refuse the claim and cancel the policy. The insured's financial position was such that it was unable to replace the property without an acknowledgement of liability by the insurer. The insured, who elected to affirm the contract, instituted proceedings seeking a declaration that the insurer was liable to indemnify it in respect of the damage caused by the fire, as well as damages and interest.

In the New South Wales Court of Appeal the insured obtained a declaration that the insurer was liable to indemnify the insured for the costs of replacement once those costs were incurred.[34] In the High Court, however, a majority held that the failure of the insured to commence the restoration and repair work with

32 *Lerer Realty Corporation v MFB Mutual Insurance Co* 474 F2d 410, 415 (5th Cir, 1973) (Godbold J).

33 (1997) 187 CLR 384.

34 *CIC Insurance Ltd v Bankstown Football Club Ltd* (1994) 8 ANZ Insurance Cases ¶61-232.

reasonable despatch meant that the insurer was liable to pay only the indemnity value of the property. In so doing, the majority indicated that the insured's position would have been better had it accepted the insurer's repudiation and terminated the contract:[35]

> [T]he Club did not pursue its claim against CIC as one to recover damages flowing from repudiation by CIC of the contract of insurance and the acceptance thereof by the Club. ... It is true that, in this period [during which the Club had failed to commence rebuilding], CIC had denied liability, but the Club's case is not that there had been a repudiation which it had accepted.

Thus, the juxtaposition inherent in the majority's judgment is that an insured who affirms and who does not rebuild cannot recover on a replacement cost basis, whereas an insured who terminates can. Although we disagree with the majority's decision,[36] and think that the juxtaposition is in this context generally false, it provides a basis for exploring doctrines that allow the insured to recover full replacement cost.

It is reasonable to ask why an insured should be entitled to fuller recovery on termination than on affirmation, when the breach complained of is the same. The stock answer, of course, is found in the general contract law rule that a party who affirms a contract remains bound by all the terms and conditions of the contract. For any contract this rule can have harsh consequences for the unwary promisee. In particular, the rule appears unsatisfactory where the repudiatory breach has contributed to the promisee's failure to fulfil a condition precedent. The rule is, however, based on the sound policy that the promisee should not be able to take up inconsistent positions, claiming that the promisor is bound but that the promisee is not. There is no middle position that the promisee can take.[37] Instead, the harsh consequences of the rule are ameliorated through the operation of other doctrines, doctrines which respond to the promisee's complaint that the promisor's repudiatory breach contributed to the promisee's failure to fulfil a condition precedent. Dixon CJ referred to two such doctrines in *Peter Turnball*:[38]

> Now long before the doctrine of anticipatory breach of contract was developed it was always the law that, if a contracting party prevented the fulfilment by the opposite party to the contract of a condition precedent therein expressed or implied, it was equal to performance thereof: *Hotham v East India Co.* But a plaintiff may be dispensed from performing a condition by the defendant expressly or impliedly

35 (1997) 187 CLR 384, 402–403 (Brennan CJ, Dawson, Toohey and Gummow JJ).

36 Our disagreement is on two levels. First, we disagree with the majority's interpretation of the reasonable despatch clause (see text, above at note 30). Secondly, we think that the insured's damages claim for breach of the obligation to pay an ordinary indemnity extended to compensation for the lost opportunity to fulfil the conditions precedent (see text, below at n 72).

37 *Fercometal SARL v MSC Mediterranean Shipping Co SA* [1989] AC 788, explaining *Braithwaite v Foreign Hardwood Co* [1905] 2 KB 543.

38 *Peter Turnball & Co Pty Ltd v Mundus Trading Co (Australasia) Pty Ltd* (1954) 90 CLR 235, 246–247 (footnote omitted).

> intimating that it is useless for him to perform it and requesting him not to do so. If the plaintiff acts upon the intimation it is just as effectual as actual performance.

The first doctrine referred to by Dixon CJ we will call the doctrine of wrongful prevention of performance. The second is the doctrine of estoppel.

(a) Estoppel

It could be argued that the insurer should be estopped from relying on the insured's non-fulfilment of the conditions precedent. In the context of a pre-existing contractual relationship the elements of estoppel are now well settled:[39] one party induces the other (usually by a representation) to make an assumption as to the parties' legal relations; the representor knows or intends the representee to rely on the assumption; the representee acts or abstains from acting in reliance on the assumption, in such a way that he or she will suffer detriment if the assumption is not fulfilled. The effect of an estoppel is to require the representor to avoid the representee's detriment, whether by fufilling the assumption or otherwise. An estoppel will require the representor to fulfil the assumption where subsequent events mean that that is the only way to avoid the detriment (for example, where it is impossible for the representee to be restored to his or her original position).[40] It does not matter that the impossibility was caused by the representee's own act provided he or she acted in reliance on the original representation.[41]

The doctrine of estoppel could be applied in the context of replacement cost insurance in the following way. The insurer's wrongful declinature induces the insured to assume that fulfilment of the conditions precedent is no longer necessary. The insured relies on this assumption by refraining from rebuilding. By the time that the insured's claim is upheld by a court it has become impossible for the insured to comply with the conditions precedent.[42] The insurer is thus required to fulfil the assumption. It follows that the insured may claim as damages the cost of rebuilding despite the failure to fulfil the conditions precedent.

In at least two cases courts have applied the doctrine in that way. For example, in *Edwards v AA Mutual Insurance Co*[43] the insured plaintiffs' property was destroyed by fire. The insurer resisted the insureds' claim on the basis of non-disclosure and misrepresentation. By the time proceedings were issued the insureds had sold their unrepaired property. It appears that the insureds never

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39 *Commonwealth v Verwayen* (1990) 170 CLR 394; *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387; *Burberry Mortgage Finanace & Savings Ltd v Hindsbank Holdings Ltd* [1989] 1 NZLR 356 (CA).

40 *Commonwealth v Verwayen* (1990) 170 CLR 394.

41 See, *e.g.*: *Maharaj v Chand* [1986] 1 AC 887, 908; *Toepfer v Warinco AG* [1978] 2 Lloyd's Rep 569, 576.

42 Either because the insured has sold the property, or because the temporal condition is worded such that compliance is no longer possible. Recall that, where the insured retains the property, and compliance with the conditions is still possible, a declaration should provide a sufficient remedy.

43 (1985) 3 ANZ Insurance Cases ¶60-668 (HCNZ). See also *City Realities (Holdings) Ltd v National Insurance Co of NZ Ltd* (1986) 4 ANZ Insurance Cases ¶60-695, 74,140 (HCNZ).

terminated the contract. At trial the insurer's defences failed. Nevertheless, the insureds' claim for damages on a replacement cost basis was resisted by the insurer on the ground that the conditions precedent had not been fulfilled. Tompkins J held that the insurer's declinature was a representation to the insureds that fulfilment of the conditions precedent was dispensed with, and that the insureds had relied on that representation, so that the insurer was estopped from relying on the non-fulfilment of the conditions.[44]

We think that the doctrine of estoppel should not be applied in this way, for two reasons. The first is that the doctrine can be applied only by fictionalising the interaction between insurer and insured. Thus, in this context the doctrine lacks explanatory force. The second is that the application of the doctrine can produce results that are inconsistent with a fundamental principle on which damages are assessed.

As to the first reason, an estoppel can be found only if the court construes the insurer's wrongful declinature as a representation inducing the insured to assume that fulfilment of the conditions precedent is no longer required. This is a wholly fictional construct. It is true that a repudiation, such as a wrongful declinature, can contain a representation.[45] But for an estoppel to arise the insurer's representation would have to be "if you wish to recover full replacement cost, you no longer have to comply with the conditions precedent". In truth the insurer is saying to the insured "we think we are not liable, so even if you comply with the conditions, we will not pay full replacement cost".[46]

In response, it could be argued that the declinature is a representation not that compliance with the conditions is *no longer required*, but that compliance is *futile*. This is more realistic. Thus, in *Foran v Wight* Deane J held that anticipatory breach amounting to a repudiation of concurrent and mutually dependent obligations often has this effect:[47]

> [I]f one party has unambiguously informed the other party that he will not perform his obligations within the time made of the essence of the contract ... the refusal to perform constitutes an intimation to the other party that the tender of performance of his concurrent obligation will be nugatory and futile.

In *Foran v Wight* the vendors informed the purchasers that they would not be ready to complete on the settlement date. This was a representation to the purchasers that it was futile for them to tender performance on that date. Likewise, the insurer's wrongful declinature can be said to be a representation that it is futile for the insured to fulfil the conditions precedent, because the insurer will not pay full replacement cost.[48] However, the important question is:

44 *Ibid.*, 79,172.

45 *Fercometal SARL v Mediterranean Shipping Co SA* [1989] AC 788, 805.

46 For instances in which a wrongful declinature was held not to amount to a representation, see *Smith v Michigan Basic Property Insurance Association* 490 NW2d 864 (Mich, 1992); *BSF Inc v Cason* 333 SE2d 154 (Ga Ct App, 1985).

47 *Foran v Wight* (1989) 168 CLR 385, 433.

48 Fulfilment is not entirely futile, because the insured will, through rebuilding, obtain a better house. However, Deane J meant futile in the sense that the other contracting

what assumption can the insured then make about the relationship with the insurer?

On Deane J's analysis in *Foran v Wight* the purchasers' assumption was that it was unnecessary to be ready, willing and able to tender performance on the settlement date. The purchasers relied on that assumption up to the settlement date, by refraining from taking further steps to obtain finance. Consequently, when the purchasers claimed that they had validly rescinded the contract for the vendors' repudiation and were therefore entitled to recover their deposit, the vendors were estopped from asserting that, in order validly to rescind the contract, the purchasers were obliged to be ready, willing and able to tender performance on the settlement date. Thus, the estoppel in *Foran v Wight* went simply to the purchasers' ability to rescind, not to their entitlement to performance.

By contrast, the only assumption that the insured can draw from the insurer's wrongful declinature is that, regardless of whether he or she rebuilds, the insurer will not pay full replacement cost. Reliance on this assumption does not estop the insurer from asserting that payment of full replacement cost remains conditional on the insured rebuilding. An estoppel to this effect would require the insured to assume that he or she no longer has to comply with the conditions in order to recover full replacement cost. In the absence of an extreme fiction, the insurer's declinature simply does not give rise to this assumption. Resorting to a fiction of this sort would be the same as finding, in *Foran v Wight*, that the purchasers could assume that they were entitled to a conveyance from the vendors without themselves paying the purchase price.

The fiction of estoppel appears again when one considers the requirement of reliance by the insured. For an estoppel to arise the court would have to find that the insured refrained from rebuilding in reliance upon an assumption induced by the insurer's declinature. The difficulty here is that the more probable reason for the insured's failure to rebuild is that the insured was impecunious. The insured's impecuniosity may well have been caused by the insurer's declinature, but this simply shows that the connection between the insurer's declinature and the insured's non-fulfilment is more significant than mere reliance.

The second reason for rejecting the doctrine of estoppel relates to the assessment of damages. In those cases in which courts have found an estoppel, the estoppel has been a binding one, requiring the insurer to fulfil the insured's assumption. This is because the insured was, by the time of the judgment, unable to fulfil the conditions,[49] and so it was no longer possible to return the insured to the position occupied before the assumption was made. In such cases the insured's right to damages is determined on the fictional basis that the conditions have been fulfilled. The notion of fictional fulfilment is problematic in that it is, in some instances, inconsistent with the causation principle governing the assessment of damages: that the plaintiff is entitled to damages only for such losses as were caused by the defendant's breach of contract.

party will not perform in response: the insured's fulfilment of the conditions is futile in this sense.

49 If the insured were still able to fulfil the conditions, he or she would be able to obtain a declaration.

The causation principle requires an investigation of the causal link between the insurer's breach (wrongful declinature) and the insured's loss. The relevant loss of the insured in this context is the lost entitlement to full replacement cost. Several contingencies may occur between the insurer's breach and the insured's loss that would be relevant to the principle of causation. First, the insured's financial resources may be such that the declinature does not disable them from rebuilding. Rather, the insured chooses not to rebuild while the question of liability remains uncertain, and then, while litigation is pending, sells the property to take advantage of a favourable offer.[50] A second contingency that may bring a causal link into question is where it appears that the insured would have sold the property in its damaged state regardless of the insurer's response. The insurer may try to prove this by leading evidence that the insured was, prior to the damage, trying to sell the property.[51] A third possible break in the causal chain is the prospect that the insured would have been unable, because of the act of some third party,[52] to rebuild even if the insurer had acknowledged its liability.

Consistency with the principle of causation requires that the assessment of damages take account of these contingencies. The first two contingencies depend on the hypothetical act of the insured, whereas the last contingency depends on the hypothetical act of a third party. The law treats these two hypotheticals differently. Where the hypothetical is a question of how the plaintiff would have reacted, the law determines the question on the balance of probabilities.[53] Where the hypothetical is a question of how a third party would have reacted, the law determines the question on the basis of loss of a chance.[54]

Estoppel properly accounts for the first type of hypothetical, but not the second. In relation to hypothetical acts of the insured, the reliance criterion operates in the same manner as the causation enquiry. Take the example of the insured who had, prior to the damage occurring, been trying to sell the property, but who nonetheless proves that it was more likely than not that he or she would have rebuilt had the insurer accepted the claim.[55] In a causation enquiry, the law will then treat the insurer's declinature as being the only cause of the insured's loss, with the result that the insured is entitled to full replacement cost. In an estoppel

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50 *E.g., City Realties (Holdings) Ltd v National Insurance Co of New Zealand Ltd* (1980) 4 ANZ Insurance Cases ¶60-695 (HCNZ); *National Tea Co v Commerce & Industry Insurance Co* 456 NE2d 206 (Ill App Ct, 1983).

51 *E.g., Kerr v The State Insurance General Manager* (1987) 4 ANZ Insurance Cases ¶60-781; *Bryant v Primary Industries Insurance Co Ltd* [1990] 2 NZLR 142;. *Whirlybird Holdings Ltd v National Insurance Co Ltd* (1996) 9 ANZ Insurance Cases ¶61,316

52 *E.g.*, a planning change by a local authority: *Glad Tidings Temple Missionary Society of Vancouver v Wellington Fire Insurance Co* (1965) 46 DLR (2d) 475 (BCSC); *Carlyle v Elite Insurance Co* (1986) 25 DLR (4th) 740 (BCCA); *Manhas v Sovereign General Insurance Co* (BCCA, 15 March 1999, BCD Civ J LEXIS 1265).

53 *Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602, 1610 (CA); *Astra Pharmaceuticals (NZ) Ltd v Pharmaceutical Management Agency Ltd* [2001] 1 NZLR 415, 433 (CA).

54 *Ibid.*

55 For examples where the insured failed to prove this, see *Whirlybird Holdings Ltd v National Insurance Co Ltd* (1996) 9 ANZ Insurance Cases ¶61-316; *McLean Enterprises Ltd v Ecclesiastical Insurance Office Plc* [1986] 2 Lloyd's Rep 416. The judgments in these cases evidence the close connection between reliance and causation.

enquiry, reliance will be proved, the insurer will be estopped from asserting the non-fulfilment of the conditions, and again the insured will be entitled to full replacement cost.

By contrast, estoppel fails to take proper account of the hypothetical acts of a third party. Take the insured who would have tried to rebuild had the insurer accepted liability, but whose rebuilding efforts would have been dependent on obtaining resource or planning consent from an official. Assume that there was a 30 per cent chance that the official would have granted consent. From a causation perspective, the law will compensate the insured for the lost chance to rebuild, awarding damages calculated at 30 per cent of the insured's potential benefit. The doctrine of estoppel is not sensitive in this way to the acts of the official. The official's acts can be accounted for only by means of the reliance criterion, which operates on an all-or-nothing basis. Here, reliance would not be proved, so the insured would recover nothing in relation to the potential replacement cost benefit.

Thus, estoppel operates inconsistently with the causation principle. This inconsistency matters only if the causation principle is primary, so that consistency with it is important. We think that the causation principle is primary, and that this primacy is recognised by the modern doctrine of estoppel itself. This recognition is evident in the way that a court is directed to fashion a remedy in response to an estoppel:[56] "there must be a proportionality between the remedy and the detriment which is [estoppel's] purpose to avoid". To achieve this proportionality the court must enquire what detriment the representee would suffer if the assumption on which he or she relied remained unfulfilled. That enquiry is essentially causal.

Indeed, the remedial response of the modern doctrine of estoppel is such that, in truth, the doctrine does not suffer from the inconsistency that we have shown. The court can award compensation for the insured's detrimental reliance, and there is no reason why that compensation cannot be measured, where appropriate, on a loss of a chance basis. The court is not limited, in the way that we earlier suggested, to an all-or-nothing choice between a binding estoppel or no estoppel: that is simply the way that the courts have thus far applied the doctrine in this context. Nonetheless, we remain of the view that estoppel is problematic on the causation issue. First, the all-or-nothing basis is so ingrained within the history of estoppel[57] that it is likely that some courts will continue to apply it that way. Secondly, although estoppel can now respond to these causal problems, the doctrine has no clear rules for doing so. Thus, there is no guarantee that reliance-based compensation will be calculated consistently with the causation principle.

(b) Wrongful prevention of performance

The second doctrine on which the insured may rely to recover full replacement cost is the doctrine of wrongful prevention of performance. Several North American courts have held that, where the insurer's declinature prevents the

56 *Commonwealth v Verwayen* (1990) 170 CLR 394, 413 (Mason CJ).

57 *Ibid.*, 454 (Dawson J).

insured from fulfilling the conditions precedent, the insured is deemed to have fulfilled the conditions.[58] The insured is then entitled to a remedy on the basis of full replacement cost. For example, the Nebraska Court of Appeals reasoned that: "A condition is excused if the occurrence of the condition is prevented by the party whose performance is dependent upon the condition."[59] Similarly, the Michigan Court of Appeals ruled that "if an insurer hinders an insured's performance of a condition precedent, that performance is excused on equitable grounds".[60] Two qualifications must be added to these statements. First, it is implicit in these cases that the insurer's preventive conduct must have been wrongful: usually, of course, a wrongful declinature. Secondly, although the courts use the language of "excuse" they do not use that term in its (usual) sense of a promisor being excused from liability in damages for non-performance. Instead, the courts mean that the insured may recover *as if the conditions had been performed*. Thus, the doctrine that has been applied in these cases may be expressed thus: if the insurer, by its wrongful act, prevents the insured from fulfilling the conditions precedent, the conditions are deemed to have been fulfilled.

Courts in other jurisdictions have not, so far as we are aware, applied such a doctrine in the context of replacement cost conditions.[61] Nevertheless, the doctrine should not be altogether foreign to lawyers outside North America. Thus, *Chitty on Contracts* suggests that the doctrine of wrongful prevention is of general application, allowing a promisee who has affirmed a contract to be released from performance of the prevented obligation.[62] Similarly, courts often imply into contracts terms that reflect an expectation that the parties should co-operate towards achievement of contractual goals, rather than prevent them. Thus, if a contract is made subject to a condition precedent, the contract may be construed as imposing an obligation on the parties to do nothing to prevent the fulfilment of that condition.[63]

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58 *Zaitchick v American Motorists Insurance Co* 554 FSupp 209 (SDNY, 1982); *Bailey v Farmers Union Co-operative Insurance Co of Nebraska* 498 NW2d 591(Neb Ct App, 1992); *McCahill v Commercial Union Insurance Co* 446 NW2d 579(Mich Ct App, 1989); *Pollock v Fire Insurance Exchange* 423 NW2d 234 (Mich Ct App, 1988); *Maine Mutual Fire Insurance Co v Watson* 532 A2d 686 (Ma, 1987); *State Farm Fire & Casualty Insurance Co v Miceli* 518 NE2d 357 (Ill App Ct, 1987); *Jauvin v L'Ami Michel Automobile Canada Ltee* (1986) 33 DLR (4th) 576 (Ont HCJ).

59 *Bailey v Farmers Union Co-operative Insurance Co of Nebraska* 498 NW2d 591, 598 (Neb Ct App, 1992).

60 *McCahill v Commercial Union Insurance Co* 446 NW2d 579, 585 (Mich Ct App, 1989).

61 Such a doctrine was relied on by the insured in *Edwards v AA Mutual Insurance Co* (1985) 3 ANZ Insurance Cases ¶60-668, but Tompkins J based his decision on estoppel.

62 (28th ed, 1999) 25-011. The only authority cited is *Bulk Oil (Zug) AG v Sun International Ltd* [1984] 1 Lloyd's Rep 531.

63 *Inchbald v Western Neilgherry Coffee, Tea, and Cinchona Plantation Co Ltd* (1864) 17 CBNS 733; 144 ER 293. Similarly, if a contract can be performed only during the continuance of a certain state of affairs, a term may be implied preventing either party from doing anything to put an end to that state of affairs: *Stirling v Maitland* (1864) 5 B & S 840, 852; 122 ER 1043, 1047; *Rhodes v Forwood* (1876) 1 App Cas 256, 274; *William Cory & Son Ltd v City of London Corporation* [1951] 2 KB 476, 484. Alternatively, the parties may come under a positive obligation to do all that is

The wrongful prevention doctrine is an improvement on the estoppel doctrine because it responds to the true facts, rather than to a fictionalised account of them. The structure of the doctrine reflects our intuitive normative opposition to the insurer's argument: the insurer should not be able to rely on the insured's non-fulfilment of the conditions *because the insurer's breach prevented the insured from fulfilling them*. For this reason, the doctrine has strong explanatory force.

However, the wrongful prevention doctrine is, in the same way as estoppel, inconsistent with the principle of causation. This is because the doctrine operates on the basis of deemed (or fictional) fulfilment of the conditions. This is not a problem where one is dealing with hypothetical acts of the insured: the question whether the insurer's breach prevented the insured from fulfilling the conditions is the same as the causation question. As we saw with estoppel, however, the doctrine will account for the hypothetical acts of a third party in a way that is inconsistent with the causation principle.

Indeed, the wrongful prevention doctrine is, on this ground, inconsistent with the law of (at least) Australia and England. In Australia, where a party wrongfully prevents the fulfilment of a condition precedent, the solution is not fictional fulfilment, but simply that the innocent party has a claim for damages.[64] Although the House of Lords long ago in *Mackay v Dick* gave credence to the concept of fictional fulfilment,[65] it has been explained that that decision involved an application of Scottish law, and that the fictional fulfilment of conditions precedent is not a principle of English law.[66] By contrast, a recent judgment of the Supreme Court of Canada is explicable only on the basis of fictional fulfilment.[67] That was, however, a two-sentence judgment in which the point was not analysed.[68]

(c) Breach and causation

How then can recovery on a replacement cost basis be coherently explained? In our view the explanation lies in a proper understanding of the damages claim available to an insured for breach by the insurer of the (accrued) obligation to pay an ordinary indemnity. We will see that the insured's ability to recover on a replacement cost basis depends simply on the application of the ordinary rules of damages to that breach.

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necessary (as opposed to reasonable) to secure performance of the contract: *Mackay v Dick* (1881) 6 App Cas 251, 263; *Sprague v Booth* [1909] AC 576, 580; *Colley v Overseas Exporters* [1921] 3 KB 302, 309; *Mona Oil Equipment and Supply Co Ltd v Rhodesia Railways Ltd* [1949] 2 All ER 1014, 1018.

64 *Newmont Pty Ltd v Laverton Nickel NL* [1983] 1 NSWLR 181 (PC); *Foran v Wight* (1989) 168 CLR 385, 455–457.

65 (1881) 6 App Cas 251, 270.

66 *Thompson v ASDA-MFI Group Plc* [1988] 1 Ch 241. By way of example, see *Inchbald v Western Neilgherry Coffee, Tea, and Cinchona Plantation Co Ltd* (1864) 17 CBNS 733; 144 ER 293. For this reason the statement quoted above from *Chitty on Contracts* (at n 62), and the statement in 9(1) *Halsbury's Laws of England* (4th ed reissue) para 969, are both doubtful.

67 *Cohnstaedt v University of Regina* [1995] 3 SCR 451; (1995) 131 DLR (4th) 605.

68 For cogent criticism of the judgment, see Clark, "Loss of a Chance in (and by) the Supreme Court of Canada" (1997) 75 *Can Bar Rev* 564.

To see how this is so, it is useful to begin by exploring one further possible explanation, one that we set up merely as a foil to make our point. We referred above to the rule that, if a contract is made subject to a condition precedent, there may be implied into the contract an obligation on the parties to do nothing to prevent the fulfilment of that condition.[69] This rule could be applied in the replacement cost context. Recovery of replacement cost is made subject to two conditions. Therefore, the contract could be construed as imposing an implied obligation on the insurer to do nothing to prevent the fulfilment (by the insured) of those conditions. The insurer's wrongful declinature could be regarded as a breach of that implied obligation.

This, however, is unnecessarily complex. For one thing, application of the rule would give rise to the question whether the declinature prevented fulfilment of the conditions, and this in turn would lead to difficult questions about what degree of hindrance counted as "prevention".[70] But, more fundamentally, the rule seeks to find a breach of an implied term where there already is clearly a breach of a specific term. Thus, an insurer's wrongful declinature is quite clearly a breach of the obligation to admit liability and pay an ordinary indemnity. It adds nothing to say that the declinature is also a breach of an implied obligation not to prevent fulfilment of conditions precedent. Devlin J explained long ago that application of the rule was unnecessary where there already was a breach of contract:[71] "[E]xcept possibly in rare cases where the wrongful act alleged is independent of the contract, the allegation of prevention is only circumlocution. Where the wrongful act is a breach of the contract, it can stand alone."

In our view recovery by the insured of damages on a replacement cost basis is dependent on applying the ordinary damages rules to the insurer's breach, as evidenced in its wrongful declinature. The fundamental damages rule is that the plaintiff is entitled to be compensated for such losses as were caused by the defendant's wrong.[72] For breach of contract this means that the award of damages should put the promisee (insured) in the same position as he or she would have been in had the promisor (insurer) performed the obligation. This requires, therefore, a comparison between the actual position that the insured is in (not having fulfilled the conditions) and the hypothetical position that the insured would have been in had the insurer accepted liability. To determine the latter position, we finally have to ask what the insured would have done had the insurer accepted liability.

The answer to that final question depends on examining various contingencies. As we saw earlier, some of those depend on what the insured would have done: would the insured, even if the insurer had accepted liability, have sold the property in its unrepaired state? Other contingencies depend on what a third

69 See text, above at note 63.

70 *E.g.*, if the declinature did not make fulfilment practically impossible, but merely more difficult, would this count as prevention? In our view the underlying question can be more coherently phrased in the more familiar terms of causation: what loss was caused by the insurer's declinature?

71 *Mona Oil Equipment and Supply Co Ltd v Rhodesia Railways Ltd* [1949] 2 All ER 1014, 1017.

72 This is subject to questions of remoteness and mitigation, but those questions are irrelevant here.

party would have done: if the insured had wanted to rebuild, would an official have permitted the insured to do so? We saw that neither estoppel nor the doctrine of wrongful prevention dealt with third party contingencies in a manner consistent with the causation principle. A damages enquiry avoids this problem, because the enquiry involves an application of the causation principle.

In summary, if the insured proves on the balance of probabilities that he or she would have rebuilt had the insurer admitted liability, the insured should be entitled to such damages as will put him or her in the position he or she would have been in had rebuilding occurred. Had the insured been in that position, he or she would have been entitled to recover full replacement cost from the insurer. Therefore, the insured should recover damages "on a replacement cost basis". However, it is important to remember that such damages are for breach of the obligation to pay an ordinary indemnity; they are not for breach of the obligation to pay replacement cost. Finally, any damages award should be discounted by the probability (if any) that the intervening act of a third party would have prevented the insured from rebuilding.

We return now to consider the insurer's argument that the insured cannot recover full replacement cost because the conditions have not been fulfilled. For an insured who has affirmed the contract, the insurer's argument misses the point, because the insured's claim for damages is not for breach of the replacement cost obligation; it is merely for breach of the obligation to admit liability and pay an ordinary indemnity. For an insured who has terminated the contract, the insurer's argument is refuted by the rule that a terminating party need only show that he or she was ready, willing and able to fulfil the conditions precedent to the relevant obligation.[73] An insured who has terminated can, therefore, sue for breach of the replacement cost obligation, so long as readiness, willingness, and ability are shown. As it happens, we suspect very few insureds will be able to show this. The problem lies with showing *ability* to fulfil the conditions. For most insureds the insurer's wrongful declinature will mean that they would not have been able to fulfil the conditions. In our view, the proper response of the law in such a situation is not fictionally to estop the insurer from relying on the insured's lack of ability, nor fictionally to deem the insured to have had the ability to fulfil the conditions. The most coherent response is to say that the insured is able to claim damages only for breach of the obligation to pay an ordinary indemnity. However, this claim for damages will, as we have just seen, often provide the insured with an indirect recovery of damages on a replacement cost basis.

This analysis undermines the assumption, to which we referred earlier, that an insured who terminates is in a better position than one who affirms the contract. There is, indeed, little to distinguish these positions. The reason for this is that a promisee's purpose in terminating a contract is to be discharged from further performance of his or her primary obligations. Such a discharge has two effects. First, it means that the promisee has no liability in damages for the non-performance of those obligations. This effect of termination is irrelevant in this context, because the conditions precedent to recovery of full replacement cost are not promissory conditions. The other effect of a discharge is that, where

73 Above, text at note 22.

an obligation of the promisor is conditioned on performance by the promisee, the promisee may sue on that obligation without tendering actual performance; instead, the promisee need only show that he or she was ready, willing, and able to tender performance. This effect of termination is of little practical relevance, because the insurer's repudiatory breach will equally prevent the terminating insured from proving ability to perform as it will prevent the affirming insured from actually performing.

VI: Conclusion

Where an insurer under a replacement cost policy wrongfully declines a claim, few would disagree that it is unfair of an insurer to argue that its liability under the policy should be limited because of the insured's non-fulfilment of conditions. This would be to allow the insurer to take advantage of its own wrong. In this paper we have tried to provide the most coherent explanation for rejecting the insurer's argument. Our explanation lies within, and is consistent with, orthodox contract law doctrine.

First, an insured may be able to obtain a declaratory remedy in terms that will allow recovery of full replacement cost. In relation to this remedy the insurer's argument is defeated partly by the terms of the declaration (which incorporates one of the conditions precedent), and partly by the application of generally applicable rules of contract construction.

Secondly, the insured may sue for damages for breach of contract. The quantum of damages depends simply on the application of ordinary damages rules. Thus, if the insured proves that rebuilding would have occurred had the insurer admitted liability, damages will be calculated on the basis of full replacement cost. If the insured does not prove that rebuilding would have occurred, damages will be calculated on the basis of an ordinary indemnity. In the former case, the insurer's argument is effectively defeated. It is important, however, to see that the defeat occurs through the application of ordinary damages rules, not through the application of fictional estoppels, nor through the fictional fulfilment of conditions.