IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA444/2021
[2022] NZCA 422

	BETWEEN	NAPIER CITY COUNCIL Appellant
	AND	LOCAL GOVERNMENT MUTUAL FUNDS TRUSTEE LIMITED Respondent

Hearing:	28-29 June 2022
Court:	Miller, Brown and Katz JJ
Counsel:	D H McLellan QC and G Tompkins for Appellant M G Ring QC, C Hlavac and M E Gall for Respondent
Judgment:	8 September 2022 at 2.00 pm

JUDGMENT OF THE COURT

A The appeal is allowed.

B The cross-appeal is dismissed.

C We remit the proceedings to the High Court to fix the amount of the respondent's liability.

D The respondent must pay the appellant one set of costs for a complex appeal on a band B basis, with usual disbursements on the appeal and cross-appeal. We certify for second counsel. The costs order made in the High Court is quashed. Costs in that Court are to be fixed there.

REASONS OF THE COURT

(Given by Miller J)

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Introduction

[1] The respondent, which we will call "RiskPool", insured the Napier City Council for breaches of professional duty extending, relevantly, to any matter on which the Council had a statutory duty or power to provide information, advice or approval. The contract of insurance, known as Protection Wording, covered liability for negligence in performance of statutory functions to authorise building work and certify compliance with the Building Code.

[2] However, cover was excluded for weathertightness defects, for which RiskPool had been unable to secure reinsurance. Exclusion 13(a) excluded "liability for Claims alleging or arising directly or indirectly out of, or in respect of … the failure of any building or structure to meet or conform to the requirements of the New Zealand Building Code … in relation to leaks, water penetration, weatherproofing, moisture,

or any water exit or control system". "Claim" meant "the demand for compensation made by a third party" against the insured.

[3] The Council was sued in 2013 by owners of a multi-unit development known as the Waterfront Apartment complex. They pleaded that it had been negligent in issuing building consents, ensuring adequate inspections and issuing code compliance certificates. Some of the defects concerned weathertightness. Others did not.

[4] RiskPool declined cover, saying that because the owners' demand for compensation included weathertightness defects their claims were entirely excluded. The Council says that only those parts relating to weathertightness were excluded.

[5] The Council settled the owners' claims, without apportioning the global payment between weathertightness and other defects, and sued RiskPool. It failed before Grice J and now brings this appeal.[1]

[6] Against the possibility that she was wrong the Judge made certain findings on quantum of RiskPool's liability, and RiskPool brings a cross-appeal against those findings. As we go on to explain, the cross-appeal addresses issues of principle. The Judge envisaged, and the parties agreed before us, that if RiskPool is liable the proceeding must be remitted to the High Court to finalise quantum.

RiskPool

[7] RiskPool is a subsidiary of New Zealand Local Government Insurance Corporation Ltd. It is the trustee of what was known as the New Zealand Mutual Liability RiskPool Scheme. The Scheme was established in 1997 in response to local authorities' dissatisfaction with the commercial insurance market. The commercial substance was that local authorities pooled risk, acting as both insured and insurer. As Members they funded claims to the extent of their annual contributions and any calls made on them for additional contributions to meet any deficit. RiskPool laid off some of its risk by reinsuring through commercial reinsurers.

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1 *Napier City Council v Local Government Mutual Funds Trustee Limited* [2021] NZHC 1477 [Judgment under appeal].

[8] The Trust Deed established a hierarchy of documents to be interpreted in order of priority: the Trust Deed, Scheme Rules, the Constitution, the Deed of Participation for each Member, and Guidelines or Protection Wording for each Member. We will use the term "Protection Wording". It was defined as "the combined liability protection wording issued to [the Member] … setting out the risks covered by the Scheme and the terms, conditions and limits in respect of those risks…"

[9] Argument before us focused closely on the Protection Wording. Documents preceding it in the hierarchy establish the mutual nature of the Scheme. However, attention should be drawn to some features of the Trust Deed. It provided that the purpose of the Scheme was to establish an annual fund to pay the Members' Civil Liabilities arising from Risks covered by the Scheme. The Board of RiskPool determined the proportions in which Members contributed and decided whether Claims from Members would be met. The Board had an absolute and unfettered discretion whether to meet Claims. When exercising the discretion, the Board was to be influenced but not bound by the Protection Wording.

[10] As Mr Ring QC for RiskPool emphasised, the existence of a discretion to meet claims, and to adhere to the language of a policy when exercising the discretion, distinguishes RiskPool from other insurers. But we were given to understand that the Board of RiskPool has not invoked the discretion to decline this claim. It has acted in reliance on the Protection Wording, which defined the cover and the exclusion. We were told that the language was substantially drawn from a commercial insurance contract. It was not suggested that the mutual context called for a different approach to interpretation.

[11] A "Claim" was relevantly defined in the Trust Deed as "any claim by a Member in respect of that Member's Civil Liability during the term of the Scheme in respect of the Risks". "Risks" meant risks of Civil Liability within the Guidelines and "Civil Liability" meant any civil liability resulting from an obligation, function, power or duty arising under law and included negligence.

[12] It will be seen that this wording defined a Claim as a claim by a Member on RiskPool for cover in respect of a Civil Liability of the Member. It was distinguished

from an Underlying Claim, which was a claim by a third party against a Member for any Civil Liability covered by the Protection Wording. The concept of an Underlying Claim was used to decide, by reference to the amount of such claim, whether any decision to settle had to be made by a Board committee.

[13] Local authorities appear to have had high hopes for RiskPool when it was established. It was envisaged that over time the Scheme would build a surplus that could meet claims. It did not work out that way, as Grice J explained.[2] An initial surplus was wiped out by leaky building claims in the early 2000s and from then on the Scheme could not obtain reinsurance on terms matching the Protection Wording. The resultant obligation to fund such liabilities eventually led to Members leaving the Scheme.

Gradual exclusion of liability for weathertightness defects

[14] Much attention was paid in the High Court, and in argument before us, to evolution of the Protection Wording. It is the 2009 wording which is in issue in this case. Earlier material forms part of the context. Its impact on the meaning of the weathertightness exclusion was disputed before us. We record that the specific documents which we describe below evidence dealings between RiskPool and its members, including the Council. Grice J found inadmissible evidence of negotiations between reinsurers and RiskPool, to which the Council was not privy, and that decision was not challenged before us.[3]

[15] It is, however, common ground that reinsurers removed weathertightness cover and, faced with worsening claims, RiskPool gradually followed suit. The narrative was provided by Paul Carpenter, an insurance broker who provided Scheme management services to RiskPool. Reinsurers wanted to avoid liability for claims that had their genesis in systemic failures. In 2002 they introduced an exclusion for toxic mould. In 2003 the Weathertight Homes Resolution Service was established as what Mr Carpenter described as a claimant-friendly jurisdiction. Reinsurers introduced a

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2 At [27].
3 At [257].

partial exclusion for weathertightness claims, but RiskPool did not fully mirror this exclusion in Protection Wording at the time.

[16] In 2006 reinsurers imposed a full weathertightness exclusion. RiskPool modified the Protection Wording in consequence, but it did not fully exclude weathertightness cover. Rather, on 29 June 2006 it wrote to the Council advising that it had resolved to introduce a sub-limited cover of $500,000 for "multi-unit building defect claims *involving* alleged breaches of cl E2 'Moisture Ingress' of the Building Code". RiskPool achieved this by introducing an exclusion for such claims and an extension supplying cover up to the sub-limit. We have italicised the word "involving", which Mr Ring emphasised. It also appeared in a RiskPool Board paper in a heading to proposed endorsements to the Protection Wording. The heading was "Exclusion 13 Multi Unit Building Defect Claims Involving Moisture Ingress".

[17] The Protection Wording subsequently supplied to the Council on 29 August 2006 did not adopt these headings or use the word "involving" but it adopted the language of the exclusion and extension. Exclusion 13 stated that the professional indemnity cover excluded liability for "Claims alleging or arising directly or indirectly out of, or in respect of … the failure of any building or structure to meet or conform to the requirements of the New Zealand Building Code … in relation to leaks, water penetration, weatherproofing, moisture, or any water exit or control system". Extension 7 provided that notwithstanding Exclusion 13 cover was extended to indemnify members against such Claims up to the sum specified.

[18] In 2007 cover for "Weathertightness Claims" was made subject to an aggregate sub-limit of $500,000 inclusive of costs for the Fund Year. In 2008 RiskPool reported a deficit but resolved to continue cover on the current basis. It introduced a minimum excess of $50,000 to all weathertightness claims.

[19] On 11 May 2009 RiskPool advised the Council that it had resolved to cease providing weathertightness cover but would continue to manage members' weathertightness claims. In a letter of 30 June 2009 RiskPool reported that it would be making a call for additional funding having regard to the increasing size and

number of claims and the disappearance of other liable parties. Extension 7 was deleted with effect from 30 June, leaving Exclusion 13 in place.

[20] There were no material changes to the Protection Wording after 2009. But in 2012 RiskPool wrote to the Council setting out its understanding of the exclusion in connection with a separate claim concerning a property at Dalton Street. The Judge found that correspondence admissible to interpret the 2014 Protection Wording, and the Council contends that she was wrong to do so.[4] We return to this at [46] below.

The 2009 Protection Wording

[21] The professional indemnity section of the Protection Wording commenced by establishing the hierarchy of documents, to which we have referred at [8] above, and providing that the Trust Deed prevailed over the Protection Wording. It was then divided into two sections, being public liability and professional indemnity, each with its own suite of definitions, insuring clauses and exclusions.

[22] The preamble to Section B (Professional Indemnity) provided that RiskPool would indemnify the Council against breach of Professional Duty, as follows:

> To indemnify the Member up to but not exceeding the amount specified in the Schedule, against Claims first made against the Member and reported to the Fund during the period specified in the Schedule for breach of Professional Duty arising out of any negligent act, error or omission wherever or whenever the same was or may have been committed or alleged to have been committed on the part of the Member or on behalf of the Member including:
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> a) all costs and expenses incurred with the written consent of the Fund in the defence or settlement of any such Claim;
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> b) all appeal bonds.
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> In the event that the total amount paid to dispose of a Claim which would have otherwise fallen under this Protection Wording is less than the Excess specified in the Schedule, or if the defence shall be successful and the Claim is dismissed or withdrawn, the Member shall not be liable for any defence costs in excess of the Excess specified in the Schedule, provided that the defence costs were incurred with the Fund's prior agreement.

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4 At [277].

[23] Professional Duty was defined as a legal duty of care owed by the Council in respect of certain activities, including the exercise of statutory powers to provide approvals or information. But for the exclusion, this generally worded language would extend to the issue of building permits and code compliance certificates and the conduct of building inspections.

[24] "Claim" was defined:

> The term "Claim" shall mean the demand for compensation made by a third party against the Member including the costs and expenses incurred in the defence of any such Claim but shall not include the Member's costs and expenses.

[25] A Schedule set out a limit of $100 million, and an excess of $10,000, for "each and every Claim". Weathertightness claims were entirely excluded, so these limits did not apply to them. We mention them because they go some way to explain what work is done by the concept of a "Claim". The excess clause stated:

> In respect of each Claim made against the Member the amount of the Excess specified in the Schedule shall be borne by the Member at its or their own risk and the Fund shall only be liable to indemnify the Member in excess of such amount. For the purpose of this Condition the term "Claim" shall be understood to mean any and all Claims which are within the scope of this Section of the Protection Wording and any Extension which may be included, and which arise out of the one event or by reason of the same negligent act, error or omission.

[26] A list of exclusions began with the words "[t]his Section of the Protection Wording does not cover liability for …". The first was the excess. Others were defined by type of liability; for example, any legal liability in consequence of war, or any negligent acts in the United States. Others used the defined term Claim to exclude any demand for compensation against the Council that was made outside New Zealand or which arose out of, for example, breach of contract or the approval of a subdivision. As this Court remarked when dismissing a strikeout appeal, it is unclear whether the drafting is fine art or a "bit of a mess".[5]

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5 *Local Government Mutual Funds Trustee Ltd v Napier City Council* [2019] NZCA 444 [Court of Appeal strike out decision] at [33].

[27] We observe that the definition of "Claim" in the Trust Deed, which it will be recalled takes priority over the Protection Wording, refers to a claim *by* a member in respect of its civil liability, while the definition in the Protection Wording refers to demands made *against* the member by a third party.

[28] However, this was undoubtedly a "claims made" policy. The indemnity and Exclusion 13 both use the defined term "Claim", meaning a demand for compensation made by a third party. We have already referred to Exclusion 13 but quote it here:

> 13) This Section of the Protection Wording does not cover liability for Claims alleging or arising directly or indirectly out of, or in respect of:
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> a) the failure of any building or structure to meet or conform to the requirements of the New Zealand Building Code contained in the First Schedule to the Building Regulations 1992 … in relation to leaks, water penetration, weatherproofing, moisture, or any water exit or control system; or
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> b) mould, fungi, mildew, rot, decay, gradual deterioration, micro-organisms, bacteria, protozoa or any similar life forms, in building or structure.[6]

The argument

[29] Mr McLellan QC, for the Council, defined the issue as whether generally covered liabilities arising from causes unrelated to weathertightness are excluded by a limiting provision in a policy of insurance which refers specifically to weathertightness only. The exclusion is concerned not with "Claims" but "liability for Claims", which confirms its narrow focus. The language of the insuring clause and exclusion recognise that multiple Claims may arise from any given negligent act and such Claims may include separate and divisible losses arising from unrelated defects or causes. Some owners might demand payment for non-watertightness defects only. The Protection Wording recognises the possibility of multiple Claims by allowing RiskPool to aggregate Claims for some purposes. Nothing in Exclusion 13 allows RiskPool to aggregate Claims to exclude cover, nor does it specify that in the case of a "mixed" demand the exclusion operates against the entire Claim.

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[6] Counsel agreed that (b) adds nothing of relevance to the exclusion for present purposes and we proceed accordingly.

[30] Counsel submitted that on analysis, and contrary to the view taken by Grice J, no authority supports RiskPool's contention that "claim" can be used to define the scope of cover; the cases were concerned with notification of claims within the correct policy period, or whether new allegations fell outside a policy period, or whether a primary or excess insurer was on risk. As the cases recognise, the meaning of "claim" or "demand" depends on the purpose and language of the particular policy and it is a question of substance not procedural form. In this policy the correct question is whether a third-party claimant is seeking compensation for weathertightness defects. If and to the extent it is, the exclusion applies.[7] Counsel submitted that Grice J was wrong to rely on extrinsic evidence (the Dalton Street correspondence) to reach a contrary interpretation.

[31] Mr McLellan added that RiskPool's approach would lead to absurd results. If a plaintiff sued for entirely non-weathertightness defects and later amended its claim to include a weathertightness defect, a claim which was entirely covered would become entirely uncovered because, to use the Judge's term, it was "tainted".[8] That would be so even if the weathertightness defect added to the claim was trifling. Grice J attempted to meet this absurdity by holding that a de minimis threshold applied, but contract law recognises no such general principle and there is no scope for an implied term. Nor does the existence of a discretion to indemnify in the Trust Deed assist, since there is nothing to suggest the discretion was included for this purpose.

[32] Finally, counsel submitted, if the wording is ambiguous the exclusion must be interpreted against RiskPool, which introduced it without negotiation.

[33] Mr Ring argued that the evolution of the Protection Wording shows that the exclusion was intended to exclude Claims "involving" moisture ingress, which can only mean that such Claims included but were not limited to moisture ingress. An exclusion can have an extensive impact on cover, and this one did: the parties' objective was the total exclusion of cover for weathertightness claims. The Judge correctly reasoned that a "Claim" alleging weathertightness has "the widest ambit" because it relates back to the demand for compensation and literally "taints" the entire

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7 *Body Corporate 326421 v Auckland Council* [2015] NZHC 862 [*Nautilus*].
8 Judgment under appeal, above n 1, at [50].

claim.[9] This view is consistent with the *Wayne Tank* principle (where a loss has two causes, one covered and the other excluded, there is no indemnity).[10]

[34] Developing this argument, counsel contended that the "demand for compensation" refers to compensation sought as a whole for wrongful conduct also as a whole. Neither the cause nor the components of the claimant's loss is an essential feature of the demand. Nor is a claim synonymous with a cause of action or a head of loss. Where many plaintiffs sue on one event, or one plaintiff advances multiple causes of action, each is a separate vehicle to advance an overarching demand or claim for compensation. A demand for compensation need not include details that would be required to plead a cause of action; it may be framed at a high level of abstraction. Counsel sought support for this approach in the leading authorities, notably *West Wake Price & Co v Ching* and *Haydon v Lo & Lo*.[11]

[35] Mr Ring pointed out that in a building defects claim allegations about weathertightness are usually pleaded at the level of mere particulars, as happened in this case; each plaintiff sought compensation for economic loss (depreciated market value) and the measure of loss was the cost of remedying all defects. The substance of it was a single demand for payment arising from each plaintiff's engagement with the Council. Each of the 51 plaintiffs mounted a single cause of action in negligence, resulting in 51 Claims which were then aggregated for the purpose of the insuring clause and the exclusion. The plaintiffs were indifferent to how the settlement sum was divided among the causes of loss.

[36] Mr Ring invoked the Council's history of renewals since 2006, arguing that it shared with RiskPool a common understanding that the policy language excluded any claim "involving" weathertightness. That was confirmed by the Council's failure to object when RiskPool rejected the Dalton Street claim on this very ground. Instead the Council again renewed its cover.

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9 At [90].

10 *Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corp Ltd* [1974] QB 57 (CA).

11 *West Wake Price & Co v Ching* [1957] 1 WLR 45 (QB); and *Haydon v Lo & Lo* [1997] 1 WLR 198 (PC).

[37] Finally, counsel argued that the de minimis principle applies; alternatively, the mutual context and the Board's discretion to pay eliminate any risk that a trifling connection to weathertightness would lead to indemnity being declined.

Admission and admissibility of evidence of negotiations

[38] Grice J devoted a substantial part of her judgment to the background, the evolution of the Protection Wording, and the parties' conduct after the Wording took its final form in 2009.[12] The Judge inquired into these matters partly because this Court, when declining to strike out the Council's claim, had reasoned that extrinsic evidence might resolve ambiguities in the language of the Protection Wording.[13] Judgment was also pending in *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, in which the Supreme Court was expected to address admissibility of prior negotiations and subsequent conduct in aid of contract interpretation.[14]

[39] We must say something about *Bathurst*, because Mr Ring argued that it justified admission of correspondence about the Dalton Street claim. The Supreme Court explained when granting leave in *Bathurst* that it would not revisit the "objective" or intended meaning approach to contract interpretation that had been adopted in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, in which the Court had held that:[15]

> … the proper approach is an objective one, the aim being to ascertain "the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract". This objective meaning is taken to be that which the parties intended. While there is no conceptual limit on what can be regarded as "background", it has to be background that a reasonable person would regard as relevant. Accordingly, the context provided by the contract as a whole and any relevant background informs meaning.

[40] In *Bathurst* the Court held that the admissibility or otherwise of extrinsic evidence, and the application of any related exclusionary rules, is to be regarded as an

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12 At [176]–[296].
13 Court of Appeal strike out decision, above n 5, at [38].
14 *Bathurst Resources Ltd v L & M Coal Holdings Ltd* [2021] NZSC 85, [2021] 1 NZLR 696.
15 At [43], quoting *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [2015] 1 NZLR 432 at [60].

evidential issue.[16] The Court referred to ss 7 and 8 of the Evidence Act 2006 and held that:[17]

> … evidence is prima facie admissible if it has a tendency to prove or disprove anything of consequence to determining the meaning the contractual document would convey to a reasonable person having all the background knowledge reasonably available to the parties in the situation in which they were at the time of the contract. We say prima facie as relevant evidence may still be inadmissible in terms of s 8, or in terms of one of the Act's (or any other Act's) exclusionary provisions.

[41] If read in isolation, this might cast a wide net, admitting a great deal of evidence which is said, by one party or the other, to tend to prove or disprove anything of consequence to meaning.[18] But as we have just explained, the Court had affirmed an objective approach to contract interpretation, under which the parties' intended meaning is that which the contract would convey to a reasonable person with the background knowledge reasonably available to the parties at the time. The objective standard is grounded in policy objectives of certainty, of holding people to their bargains, and of efficiency in the conduct of proceedings.[19] In many cases, including this one, the parties have framed their contract in writing and their intended meaning is extracted from the document. The language of the document retains primacy, and evidence extrinsic to the document is confined to what a reasonable person would consider relevant.[20]

[42] By way of confirmation, we refer to judgments of Lord Hoffmann from which, as the Court made clear in *Firm PI*, the objective approach is drawn.[21] In one of those judgments, *Bank of Credit and Commerce International SA v Ali*, Lord Hoffmann explained that when stating in *Investors Compensation Scheme Ltd v West Bromwich Building Society* that the admissible background included "absolutely anything which would have affected the way in which the language of the document would have been

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16 At [54].
17 At [62] (footnotes omitted).
18 David McLauchlan "The Lottery of Contract Interpretation" [2021] NZLJ 256 at 257.
19 *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, above n 14, at [46].
20 At [46].
21 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 15, at [60], citing *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 912; *Chartbook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 at [14]; *Attorney-General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988 at [16]; and *Bank of Credit and Commerce International SA v Ali* [2001] UKHL 8, [2002] 1 AC 251 at [39].

understood by a reasonable man" he did not think it necessary to emphasise that he meant "anything which a reasonable man would have regarded as *relevant*".[22] The language of the contract, interpreted in accordance with conventional usage, remains the primary source of meaning. He did not mean to encourage "a trawl through 'background' which could not have made a reasonable person think that the parties must have departed from conventional usage".[23]

[43] So extrinsic evidence is admissible if it crosses a threshold of a) relevance and b) probative value relative to the risk that it will needlessly prolong the proceeding. When approaching the threshold courts must look first to the language of the contract, interpreted in accordance with ordinary usage. That language retains primacy and its ordinary meaning is a powerful, but not conclusive, indication of shared meaning.[24] Extrinsic evidence must be adjudged reasonably capable of altering the ordinary meaning before it is admissible. As with any reasonableness standard, this calls for the exercise of judgement.

[44] Consistent with this, the Supreme Court explained in *Bathurst* that the law governing the interpretation of contracts determines what is relevant and admissible extrinsic evidence:[25]

> [55] The approach to be taken to contractual interpretation is governed by the law of contract, but it is the law of evidence that ensures the trial court's inquiry focusses only on evidence that will materially assist in applying that test. The rules of evidence do not, therefore, operate independently of the law of contractual interpretation. Rather, the law of evidence serves the law of contract. As we discuss more fully below, it is the law governing the interpretation of contracts which fundamentally shapes what is relevant, and what is therefore admissible, extrinsic evidence.
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> (Footnote omitted.)

[45] The Court added that the admissibility of extrinsic evidence is to be regarded as an evidential issue, to be determined in accordance with the law of evidence "in light of the substantive law on contractual interpretation discussed above" (referring to the objective approach).[26] It later reiterated that the objective standard for contract

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22 *Bank of Credit and Commerce International SA v Ali*, above n 21, at [39].
23 At [39].
24 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 15, at [63].
25 *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, above n 14.
26 At [57].

interpretation is the standard against which relevance and probative value must be measured.[27] It contemplated that trial judges will exclude evidence which is not relevant or not sufficiently probative to justify its impact on the proceeding.[28] It applied that approach when holding that extrinsic evidence of which one party was unaware is irrelevant and hence inadmissible to interpret the contract.[29]

[46] That brings us to the Dalton Street correspondence, on which Grice J relied when interpreting the Protection Wording. A claim against the Council was made in 2012. It alleged weathertightness and non-weathertightness defects in a building at Dalton Street. The Council notified RiskPool, which declined indemnity by letter:

> You have requested that RiskPool give consideration to the provision of indemnity under our protection wording for this matter which originated out of weathertight defects and is now the subject of non-weathertight defects.
>
> We have obtained appropriate legal advice in relation to this situation arising and can confirm that indemnity is not provided under our protection wording. Our advice concludes, should a claimant's allegations constitute one claim, and an exclusion such as our 'weathertight exclusion' 13(a) or (b) apply to the claim, the entire claim is excluded.
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> Essentially, should the claimant allege that all the breaches of the weathertight standards in the building code account for all the loss, breaches of other standards in the building code effectively provides an alternative basis for recovering the same loss. This scenario encompasses a type of claim RiskPool and its Members have agreed not to indemnify by way of exclusion.

The Council did not reply. It did not pursue a claim against RiskPool. We were given to understand that it settled with the plaintiff.

[47] Grice J found this information relevant and probative, reasoning that it was evidence as to the parties' mutual knowledge when they renewed cover for the 2014–2015 year in which the present Claim was made.[30] Mr McLellan condemned this as an unprincipled reliance on subjective evidence. Mr Ring defended it as a correct application of what he described as the *Bathurst* principle that to a reasonable observer, the reasonable inference from the totality of the Council's conduct was that, as of the

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27 At [65].
28 At [63]–[64].
29 At [83].
30 Judgment under appeal, above n 1, at [277] and [314]–[326].

date of the next renewal, the Council "shared RiskPool's view on the application of the exclusion".

[48] We observe that the Council's silence is said to show not that the parties had negotiated an agreement about the exclusion but rather that they shared what can only have been a subjective understanding about what it meant. The fact that it was evidenced in contemporaneous correspondence does not alter its subjective character.

[49] Conduct of this kind may be admissible, following *Bathurst*, as evidence of a "common mutual understanding" , but its probative value depends on showing that it was indeed mutual.[31] If it was not, it is prima facie irrelevant.[32] If relevant, its probative value must be such as to justify the costs to the proceeding of adducing it. A court may make such assessment on a threshold inquiry, before the costs are incurred.

[50] Turning to the facts, we find the inference unjustified. RiskPool certainly asserted that mixed claims were excluded. But the last paragraph explained that was so where the claimant alleged that *all* of the loss was accounted for by weathertightness defects; in such a case it did not matter that some of the loss might also involve breaches of other provisions of the Building Code. If that was indeed the claimant's position — counsel could not tell us — there is an alternative explanation for the Council's inaction; cover was excluded because the *Wayne Tank* principle applied. The Council's silence in response to the letter is accordingly ambiguous.

[51] It follows that the inference for which Mr Ring contended could not be drawn without inquiring into the circumstances of the Dalton Street claim and dealings between the Council and RiskPool about it. Grice J recognised this. She considered some evidence, but it seems relevant witnesses were not available or not called.

[52] It will be recalled that the Judge was awaiting *Bathurst* and appreciated that the Supreme Court might enlarge the boundaries of admissible evidence. She sensibly approached fact-finding with that in mind.[33] Having the advantage of *Bathurst*, we

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31 *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, above n 14, at [76].
32 At [77].
33 Judgment under appeal, above n 1, at [184].

think she might have found the inquiry into the Dalton Street correspondence could not be worthwhile. It would entail some time and cost to the proceeding. The exercise would be to little advantage. The letter was not addressed to the terms of future cover. It was written by a claims manager in connection with an existing claim. The addressee was not the Chief Executive, who appears to have been responsible for insurance cover, but the Council's property manager. All in all, the circumstances did not demand a response directed to the terms on which cover would next be renewed. It follows that the Dalton Street correspondence should be characterised as unilateral conduct on RiskPool's part, an assertion of its position for purposes of a particular existing claim.

[53] In the result, we accept Mr McLellan's submission that the Dalton Street correspondence is irrelevant and inadmissible to interpret the Protection Wording.

[54] We add that although this is not a case in which third parties relied on the contract between RiskPool and the Council, the Protection Wording is common to other Members of the Scheme. To the extent that the correspondence affects the meaning of the Wording it must follow that identical language may have different meanings for each Member, or indeed different meanings for the same Member in different policy years. That would be remarkable in an insurance policy, and all the more so when the policy is used in a mutual setting.

[55] As a related point, we observe that conduct of the kind exhibited in relation to the Dalton Street claim might also be conceptually capable of sustaining an estoppel, but none is pleaded. That is unsurprising. It seems improbable that RiskPool could say that a representation was made by the Council or that, if it was, RiskPool altered its position in reliance on such representation by renewing cover on exactly the same terms for the Council and (presumably) every other Member of the Scheme.

The "Claim" cases

[56] Counsel devoted much attention to authorities on the meaning of "claim" in an insurance context. Mr Ring's objective was to establish that each of the 51 Waterfront plaintiffs made a single demand for compensation which, because it included compensation for weathertightness defects, was excluded in its entirety.

[57] The issue has usually arisen in cases involving a dispute about application of a policy limit or excess,[34] or as to whether a claim arose during an insured period,[35] or among insurers providing different layers of cover.[36] In each case the outcome ultimately turned on the object and language of the contract.[37] The corollary is that other cases are of limited assistance. Few of the cases touched on the scope of cover; specifically, whether cover extended to mixed claims.

[58] We do not need to discuss the authorities at length. We accept Mr Ring's submission that a Claim in the indemnity clause and Exclusion 13 is plainly a demand for compensation, not a cause of action.[38] To that extent recourse to the authorities is unnecessary.

[59] We further accept that in fact and substance[39] each of the 51 plaintiffs made a single demand against the Council, for compensation for negligence in its permitting, inspection and certifying responsibilities at the Waterfront Apartments. Each claim arose out of the same negligent course of conduct. Each plaintiff advanced only one cause of action. They accordingly must and did distinctly plead discrete defects and discrete breaches of specific provisions of the Building Code, some concerning weathertightness and some not, but they did so at the level of particulars. The compensation claimed was the aggregate cost of remedying all the defects. For purposes of the policy limit and excess, the claims could have been aggregated.

[60] To say this, however, is not to answer the Council's case. The exclusion carves out a class of Claims which are causally connected to weathertightness defects. Not all of the defects in the plaintiffs' Claims fell into that class. These were mixed Claims

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34 *Haydon v Lo & Lo*, above n 11; *Mabey & Johnson Ltd v Ecclesiastical Insurance Office* [2003] EWHC 1523 (Comm), [2004] Lloyd's Rep 10; *Trollope & Colls Ltd v Haydon* [1997] 1 Lloyd's Rep 244 (CA); *Murphy v Swinbank* [1999] NSWSC 934; and *Citibank NA v Excess Insurance Co Ltd* [1999] 1 Lloyd's Rep 122 (QB).

35 *Thorman v New Hampshire Insurance Co (UK) Ltd* [1998] 1 Lloyd's Rep 7 (CA).

36 *Baulderstone Hornibrook Engineering Pty Ltd v Gordian Runoff Ltd* [2006] NSWSC 223, (2006) 14 ANZ Ins Cas 61-701.

37 See *Murphy v Swinbank*, above n 34, at [490], quoting *Schipp v Cameron* [1999] NSWSC 997 at [958].

38 In *Haydon v Lo & Lo*, above n 11, for example, the first issue was whether "claim" was used in the same sense in the insuring clause and the policy limit/deductible, to mean a claim by a third party against the insured. See also *West Wake Price v Ching*, above n 11, at 829–831; and *Thorman v New Hampshire Insurance Co (UK) Ltd*, above n 35, at 16.

39 *Haydon v Lo & Lo*, above n 11, at 204–207; and *Mabey & Johnson Ltd v Ecclesiastical Insurance Office*, above n 34, at [12(4)–(5)] and [36].

in which the demand for compensation was the aggregate sum of repair costs for defects some of which were indemnified and some not. The compensation claimed from all defects is greater than that from weathertightness defects (including mixed defects) alone.

[61] There was some debate about this very important point in oral argument. Mr Ring observed that weathertightness defects often go hand in hand with other building defects and it can be hard to distinguish them by cause. He pointed to items in the Waterfront complex which were alleged breaches of both weathertightness and non-weathertightness provisions of the Building Code. It appears from counsel's written submissions that the non-weathertightness defects concerned were usually durability and stability, presumably a consequence of moisture ingress. We were told that it was common ground at trial that mixed defects falling into that category were excluded. We also accept that other defects will sometimes add nothing to the cost of remedying those attributable to weathertightness. But as Mr McLellan pointed out, it has been common ground throughout that some of the items claimed in this case have nothing to do with weathertightness. Some relate to non-compliance with fire regulations and some to a structural wall. The costs of repairing these defects have been separately identified by expert witnesses. They are additional to the cost of repairing weathertightness defects.

[62] For this purpose, the most relevant of the cases cited is *West Wake Price*.[40] In issue was a "QC clause" under which the defendant underwriter agreed to pay any "claim" against the insured without requiring the insured to dispute it, unless senior counsel advised that the claim could be successfully defended. The insured was a firm of accountants. Client funds entrusted to the firm had been lost through a clerk's irregularities. The client sued for the entire loss in causes of action for negligence, money had and received, and conversion. The accountants were insured for acts of neglect, default or error, but not fraud. The client had not pleaded dishonesty against the firm, but that was not decisive; Devlin J (as he then was) held that the court could determine the true nature of the claim.[41]

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40 *West Wake Price v Ching*, above n 11.
41 At 824.

[63] The Judge held that a division of claims by cause of action might be necessary if separate claims were made for separate sums of money in respect of fraud and negligence.[42] But on the facts a most formidable difficulty confronted the argument that each cause of action amounted to a separate claim for purposes of the QC clause. The difficulty was that the insurer could not pay the claim in negligence without also discharging the claim in fraud. In that case the underwriter would have been compelled to pay a claim that was not within the policy. This difficulty drove him to decide that there was but one mixed claim combining several causes of action.[43]

[64] Devlin J then considered whether the one claim was a claim in negligence within the meaning of the policy. He considered whether the issue might be decided by looking at the real nature of the claim, or by examining proximate cause, but ultimately he decided it as a matter of construction. Under the policy language a claim in negligence must be a claim in negligence alone, and that being so a mixed claim was outside the policy.[44] He observed that a more liberal interpretation of claim was arguably more consistent with the presumed intent of the parties but would "mean that the underwriters were compelled to discharge a claim which admittedly, good or bad, was outside the limits of the policy".[45]

[65] The principle which emerges from *West Wake Price* for our purposes is that the exclusion clause should not be interpreted to force RiskPool to indemnify the Council for a liability which is outside the Protection Wording.

[66] The Council accepts this principle. It does not ask RiskPool to indemnify it for excluded weathertightness defects. It seeks indemnity for defects that are squarely within the insuring clause. The question is whether, as a matter of construction, the exclusion clause allows RiskPool to deny a request for indemnity that is within the policy limits. The answer depends on whether the Wording contemplates that a Claim is divisible when it incorporates insured and excluded liabilities that are not co-extensive (in the sense that to pay one is to discharge the other).

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42 At 830.
43 At 830–831.
44 At 831.
45 At 832.

Mixed claims under the exclusion

[67] We have found that each plaintiff made a single Claim, but that is not the end of the inquiry. For insurance purposes a third party's demand for compensation may be aggregated or divided. We have explained that under the Protection Wording, Claims may be aggregated for policy limit and excess purposes. The question is whether they may be divided according to the nature of the Council's liability. It arises because Exclusion 13 excludes cover that would otherwise respond to a breach of Professional Duty when the third party's Claim holds the Council liable for the failure of a building to meet Code requirements in relation to weathertightness.

[68] The general rule is that contracts of insurance are interpreted in the same way as any other. Interpretation is an objective search for common intention. The context here includes a settled approach to exclusion clauses in insurance law. Such clauses work by carving out exceptions to generally worded indemnity provisions. A leading text explains that:[46]

> The general principle that an insuring clause should be given a liberal construction in favour of cover and that an exclusion should be construed strictly is well known and accepted, and there is no reason why the difference should not produce different results if the language used admits of it…

And earlier states:[47]

> … [t]he process of construction begins with the insuring clause, and within this paradigm it will be read broadly and exclusions and limitation provisions will be read narrowly … In some jurisdictions, it is said that policies are not construed against the insurer, unless the expression is ambiguous, but in practical terms this leads to much the same result.

[69] As Mr McLellan submitted, ambiguity often can be resolved by reference to context and purpose. It is only where ambiguity proves intractable that recourse need be had to the contra proferentem rule.[48]

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46 Desmond Derrington and Ronald Ashton *The Law of Liability Insurance* (3rd ed, 2013, LexisNexis Butterworths, Chatswood) at [10-14].

47 At [3-6].

48 *Insurance Commission (WA) v Container Handlers Pty Ltd* [2004] HCA 24, (2004) 218 CLR 89 at [97]–[98].

[70] There can be no doubt that RiskPool intended to exclude all cover for weathertightness defects. As Mr Ring submitted, the context was that the cost of meeting such claims had become unsustainable and cover had to be aligned with the total exclusion already imposed by reinsurers. The terms on which the reinsurers did so are unknown, as we have explained. We must work with the evidence of dealings between RiskPool and its Members.

[71] That evidence does not show that the commercial purpose extended to excluding liability for non-weathertightness defects when combined in a Claim for weathertightness defects. It shows on the contrary that RiskPool continued to offer cover for non-weathertightness defects. That was part of what the Supreme Court described in *Firm PI* as the "structure" of the parties' bargain.[49]

[72] We accept that "Claim" is defined at what Mr Ring described as a high level of abstraction — a demand for compensation. But the exclusion necessarily contemplates an inquiry into the real nature of the Council's liability. It may be undertaken whenever the demand for compensation is connected to the Council's responsibilities for construction. It may descend to the level of particulars. Such inquiry need not be confined to cases in which the Claim alleges mixed causes of liability. On the contrary, on RiskPool's analysis such inquiry will examine whether any part of a Claim might be attributable to weathertightness so as to "taint" the whole.

[73] Such an inquiry into underlying clauses is orthodox when deciding whether an exclusion applies. In *Body Corporate 326421 v Auckland Council* (*Nautilus*) Gilbert J was confronted with a list of defects attributable to a number of causes.[50] Cover was excluded under a claims made policy for liability arising out of poor workmanship. It followed that a claim was not indemnified if defective workmanship was an indirect cause of the loss. Gilbert J held that:[51]

> … where the claim has two or more causes, the claim will be covered only if at least one of these causes is within the insuring clause and none of the causes is excluded by an exclusion clause.

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49 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd*, above n 15, at [64].
50 *Nautilus*, above n 7.
51 At [339] (footnote omitted).

[74] RiskPool contends, as explained above, that a Weathertightness Claim is a Claim "involving" moisture ingress and this can only mean that the excluded Claim includes but need not be limited to weathertightness defects. "Involving" does not appear in the Protection Wording, as we have explained at [16] above. The papers in which it appeared (in a heading) are admissible background, but the Protection Wording makes clear what was meant: cover does not extend to liability for Claims "alleging or arising directly or indirectly out of, or in respect of" a weathertightness defect. These words address the degree of proximity between demand for payment and underlying liability that is necessary to trigger the exclusion.

[75] We accept that the exclusion contemplates that a Claim may incorporate a number of Council liabilities. The words "alleging or arising directly or indirectly out of, or in respect of" contemplate an indirect (but specific) causal connection to weathertightness. Consistent with that, the exclusion removes cover for "liability for" Claims causally connected to weathertightness. The connection needed is between a weathertightness defect and the Council's liability to pay the compensation demanded. But the language of causation shows only that a Claim is not covered to the extent that weathertightness defects were an indirect cause of the loss for which compensation is claimed.

[76] The commercial purpose does not compel the conclusion that the parties intended to exclude liability for sums not causally related to weathertightness, as we have explained. It points rather to the conclusion that such Claims are within the indemnity but excluded to the extent they are causally attributable to weathertightness defects.

[77] Exclusion 13 should be read with the other exclusions in the Protection Wording. We mentioned them at [26] above. Some exclude liability for Claims. The list includes Claims made outside New Zealand, Claims notified under or arising out of any previous Protection Wording, and Claims for breach of contract or arising from the sale of land. Some exclusions attach to legal liabilities — those occasioned by an act of war or radiation — or negligent acts in the Unites States or Canada. Another excludes amounts awarded as exemplary damages. In these instances the Protection Wording works by subtracting from a Claim any amounts attributable to a

specified liability. To that extent the language is consistent with the use of "liability for Claims" in exclusion 13(a). It does not exclude the Claim in its entirety. Most of the exclusions which do exclude a Claim in its entirety appear to envisage that it will clearly fall within or without the relevant exclusion, such as Claims for breach of contract. One recognises that the Claim may arise directly or indirectly from certain acquisitions or sale of property, signalling that an indirect connection to the excluded cause is enough. We observe that Exclusion 13 was added to the Wording and not carefully integrated into it. The introductory words to the suite of exclusions "This section of the Protection Wording does not cover liability for" were repeated in cl 13, as if it stood alone. All in all, the other exclusions are not much help.

[78] That brings us to the question of commercial absurdity. Mr McLellan argued that if RiskPool is correct the exclusion would substantially defeat the indemnity. That seems to us debateable. It would do so only to the extent that the indemnity covers liability for construction-related liabilities and construction-related Claims allege weathertightness defects. As Mr Ring submitted, an exclusion can carve out liability to "a most extensive degree".[52]

[79] Much more telling is the argument that if RiskPool is correct the Wording excludes a Claim if a trifling part of the demand is causally connected to weathertightness. Grice J accepted RiskPool's answer that the de minimis doctrine applies, either by operation of law or as an implied term. She found support for this in the mutual nature of the Scheme and the discretion to pay Members' claims.[53]

[80] The de minimis principle is normally invoked in connection with questions of loss or departure from a specified standard, as seen in the cases cited by RiskPool.[54] None addresses the effect of the doctrine on the meaning of a contractual obligation. There are we think two clear objections to doing so. The first is that the threshold

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52 Derrington and Ashton, above n 46, at [10-2].

53 Judgment under appeal, above n 1, at [171].

54 As to de minimis cases relating to loss, we were referred to *He v Earthquake Commission* [2019] NZCA 373 at [8]; *Fitzgerald v IAG New Zealand Ltd* [2018] NZHC 3447 at [32]–[35]; *C & S Kelly Properties Ltd v Earthquake Commission* [2015] NZHC 1690 at [175] and [306]; *Kraal v Earthquake Commission* [2015] NZCA 13, [2015] 2 NZLR 589 at [35]–[37]; and *Jackson v Green* [2016] NZHC 3041 at [113]. In relation to departures from specified standards, we were referred to *Veba Oil Supply & Trading GmbH v Petrotrade Inc* [2001] EWCA Civ 1832, [2002] 1 All ER 703; and *Bruce v IAG New Zealand Ltd* [2019] NZCA 590 at [50]–[51].

cannot be defined with sufficient precision. Is it set by value or some other measure, such as the costs of investigating the claim or the gravity of the plaintiff's allegations? If set by value is it one per cent? Ten per cent? The second is that even if we assume the threshold is set at a generous level the Council's criticism still holds good; the tail is wagging the dog. We do not discern in the Wording or the context any intention to permit that. It follows that there is no scope for an implied term.[55] Nor is it a sufficient answer that RiskPool might in the exercise of discretion admit such a Claim. That begs the question, since the Trust Deed provides that the Board must be guided by the Protection Wording, and presumably will start with it.

[81] For these reasons we conclude that Exclusion 13 removed cover for the plaintiffs' claims only to the extent that the Council's liability alleged arose directly or indirectly out of, or in respect of weathertightness defects.

[82] It is not necessary, on the view we take of the Wording, to resort to the contra proferentem rule. We record that we accept Mr McLellan's submission that RiskPool was responsible, as between itself and Members, for the wording of the exclusion. The Claims here are clearly within the insuring clause. To the extent that, contrary to the view we have just expressed, ambiguity remains about the exclusion, we would accordingly resolve it against RiskPool.

The Council's quantum appeal

[83] It makes sense to deal with the Council's quantum appeal after addressing the cross-appeal. The principal issue in the cross-appeal is whether, and on what basis, RiskPool can contest the settlement reached by the Council with the Waterfront plaintiffs. Grice J accepted that where an insurer has declined liability the insured may rely on a reasonable settlement to establish the quantum of the loss.[56] She followed that rule when she apportioned loss between insured and excluded causes. It informed her approach to the issue raised in the Council's quantum appeal, which concerns her apparent decision to discount the settlement sum of $12.355 million by deducting an

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55 *Bathurst Resources Ltd v L & M Coal Holdings Ltd*, above n 14, at [106]–[107] and [116(a)], endorsing the test of "strict necessity" for the implication of terms from *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR 266 (PC).

56 Judgment under appeal, above n 1, at [353].

amount, $3.5 million, which she found the Council would have refused to pay for certain underlying liabilities, known as defects 2, 13–14 and 22.[57]

The cross-appeal: must the Council prove its at-trial liability to the plaintiffs?

[84] The general question on the cross-appeal is whether the settlement between the Council and the Waterfront plaintiffs governs the amount RiskPool must pay to indemnify the Council under the Protection Wording. As explained above, Grice J considered this issue against the possibility that she was wrong to hold RiskPool was not liable to indemnify the Council at all. She found substantially for the Council, concluding that the global settlement figure, with some deductions, is apportioned between excluded and included defects to arrive at the amount RiskPool must pay.[58]

[85] The Judge reasoned, following this Court's decision in *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd*, that "if an insurer wrongfully declines liability and leaves the insured to act as a 'prudent uninsured' the insurer has breached the essence of the contract for indemnity which gives rise to a right to cancel for repudiation".[59] It is not necessary that this "repudiatory breach" be accepted by the insured; what matters is that the breach is sufficiently serious to allow the insured to claim damages based on the denial of liability.[60] Provided that the insured acted reasonably in settling the claim, the measure of damages is the amount paid in settlement together with costs.

[86] RiskPool says this was wrong. In its notice of cross-appeal it contends that this was a claim not for repudiatory breach of contract but for indemnity in accordance with the terms of the insurance. Repudiation and its acceptance must be pleaded. On the evidence, RiskPool did not repudiate but merely adopted a mistaken interpretation of its liability under the contract. That being so, the Council had to prove that in the absence of the settlement agreement it would have been liable to the Waterfront plaintiffs in respect of its insured liability, and it also had to prove how much of the global settlement sum reasonably reflected its insured liability. This Court

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57 At [416].
58 At [376]–[393].
59 At [377], relying on *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd* (1993) 7 ANZ Ins Cas 77,972 (CA).
60 At [378].

was wrong in *Mainfreight* to hold that an insurer which repudiated liability was prevented from contending that it was not legally liable to the amount of the settlement so long as the insured acted reasonably in settling.

[87] RiskPool also alleges that the Judge was wrong to hold that, in apportioning the settlement sum, RiskPool was not entitled to a deduction from the Waterfront plaintiffs' claim for the costs of repairing defects which they had never alleged, or had abandoned, against the Council. We deal with this issue together with the Council's quantum appeal at [131] below.

[88] Mr Ring's written submissions adhered closely to the notice of cross-appeal, but in oral argument he made what he described as an attempt to avoid arguing repudiation and save us from examining *Mainfreight*. He focused on the reasonableness of the settlement at the time and now. He sought to argue that the Judge was wrong to find that $12.355 million was a reasonable global sum to pay, before apportionment between included and excluded defects. He accepted that on the record before us it is very difficult to fix the amount of RiskPool's liability, attributing this to the Judge's acceptance of a global settlement figure which, in his submission, cannot have been correct. He conceded RiskPool would have to pay something and estimated (this we did not take to be a concession) when pressed that its liability would be about 20 per cent of $12.355 million. He accepted that it is reasonable to send quantum back to the Judge provided both the reasonableness of the settlement sum and the apportionment are at large.

[89] Mr McLellan took the point that none of this was mentioned in the notice of cross-appeal or written submissions. He submitted that the repudiation point was not conceded by Mr Ring and we must decide it. He argued that there is no error in the judgment below to correct; the Judge said that she would have left the detailed calculations for the parties and accepted that, apart from the quantum she had determined in relation to defects which were not part of the global settlement amount, the balance of the global sum would require recalculation and adjustment in view of her findings.[61]

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[61] Judgment under appeal, above n 1, at [438].

[90] We accept that it is not appropriate as a matter of pleading, or possible on the argument before us, to fix the amount of RiskPool's liability. We must decide what counsel described as the repudiation issue, which is squarely before us. We will also deal with the specific quantum issues that were pleaded in the notices of appeal and cross-appeal. The proceeding must then be remitted to the Judge to fix quantum.

Does the Council's settlement fix RiskPool's liability?

[91] As a general rule, a judgment, award or settlement in proceedings between A and B does not establish the measure of B's loss in proceedings between B and C. As Gummow J put it in *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd*, it is the policy of the law to encourage settlements, but not at the expense of a third party's right of access to the courts.[62]

[92] Contracts of indemnity for liability to a third party form an exception to the rule.[63] Sir G Mellish LJ explained in *Gray v Lewis* that:[64]

> … the law with reference to express contracts of indemnity is, that if a person has agreed to indemnify another against a particular claim or a particular demand, and an action is brought on that demand, he [the insured] may then give notice to the person who has agreed to indemnify him to come in and defend the action, and if he [the insurer] does not come in, and refuses to come in, he [the insured] may then compromise at once on the best terms he can, and then bring an action on the contract of indemnity.

[93] The exception is very longstanding. It has been traced in English law to *Duffield v Scott*, and in American law to the judgment of Holmes J in *St Louis Dressed Beef and Provision Co v Maryland Casualty Co*.[65]

[94] The rationale begins with recognition that if the law were otherwise an insured could not compromise a third-party claim, or indeed make any admissions in pleadings

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62 *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 192 CLR 603 at [55] per Gummow J (dissenting, but not on this point).

63 At [58], per Gummow J, noting that contracts of indemnity in respect of liability to a third party stand in a special position as regards the effect of settlement.

64 *Gray v Lewis* LR 8 Ch App 1035 (Ch) at 1059, adopted in *Edwards v Insurance Office of Australia Ltd* (1933) SR 34 (NSW) 88 (NSWSC) at 94 per Davidson J and at 98 per Halse Rogers J.

65 *Duffield v Scott* (1789) 3 TR 374, [1775-1802] All ER Rep 621 (KB); and *St Louis Dressed Beef and Provision Co v Maryland Casualty Co* (1906) 201 US 173. See the discussion in JE Marshall and JAC Potts "Indemnity for Settlements: Proof of Underlying Liability?" (2008) 19 ILJ 97. The American authorities were discussed by Stephen J in *Distillers Company Bio-chemicals (Australia) Pty v Ajax Insurance Co Ltd* (1974) 130 CLR 1 at 24–26.

or interrogatories, but must proceed to judgment before pursuing indemnity from an insurer who had declined liability. Faced with an argument that, in proceedings between insured and insurer, a court must determine the extent to which the insured would have been held liable had the third-party claim not been settled, this Court held in *Mainfreight* that:[66]

> The very impracticality of such an approach demands its rejection. It would mean that where the insurer has breached the contract by denying liability the insured could never settle and would need to have liability and quantum determined before claiming against the insurer.

[95] Gibbs J elaborated on this point in *Distillers Company Bio-chemicals (Australia) Ptd Ltd v Ajax Insurance Co Ltd*, observing that in the ordinary course of proceedings it will often be prudent, and sometimes necessary, for a party to make an admission, offer, promise or payment in connection with the claim. It may be necessary to make admissions in response to interrogatories or in cross-examination.[67]

[96] The issue arises most starkly when an insurer declines liability, electing not to take over the defence, and subsequently resists the insured's claim for indemnity by invoking a "no admissions or settlements without consent" provision in the contract of insurance. That was the position in *General Omnibus Co v London General Insurance Co*, a judgment of the Irish Supreme Court.[68] The policy insured the operator of a fleet of buses against liability to third parties. When the operator was faced with a claim the insurer denied liability, invoking an exclusion which was later found inapplicable. It also defended the claim for indemnity on the ground that the third-party claim had been settled without the insurer's permission. Kennedy CJ held that the insurer, having "repudiated the policy in reliance upon the exclusion":[69]

> … cannot be heard, on the one hand, insisting that the policy was forfeited and repudiating all liability under it, and, at the same time, insisting that the [insurer] must give a written consent in writing to any demand or payment made by the insured.

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66 *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd*, above n 59, at 77,975–77,976.

67 *Distillers Company Bio-chemicals (Australia) Pty v Ajax Insurance Co Ltd*, above n 65, at 11–12.

68 *General Omnibus Co Ltd v London General Insurance Co Ltd* [1936] IR 596 (Irish Supreme Court).

69 At 608.

[97] Fitzgibbon J, concurring, stated that if the insurer was not justified by the terms of its contract in declining to deal with the matter, it could not now rely on the insured's failure to consult it about the settlement, characterising the insurer's repudiation as a waiver of all right to be consulted in the settlement.[70]

[98] It will be seen that the Court characterised the insurer's conduct as a repudiation of the policy. On the facts, however, all the insurer had done was deny the claim in reliance on an exclusion; it had stated that because the exclusion applied it could not accept liability in the matter.[71] That was to invoke the contract, not to deny it. The distinction is important.[72] As Mr Ring submitted, repudiation of a contract must be accepted by the wronged party, and pleaded by that party when suing on the breach.[73] The insurance cases use "repudiation" in a narrower sense, to mean denial, after notice, of liability to meet a claim under the policy.[74] As this Court explained in *D A Constable Syndicate 386 v Auckland District Law Society Inc*:[75]

> … "repudiation" means indicating a refusal to provide cover for a claim where cover ought to be provided and that triggers the finding that the insured does not have to comply with restrictions that would be relevant only if cover had been provided. In other words, it is a repudiation of liability in breach of the policy terms rather than a repudiation of the whole policy.

[99] In *Distillers* a pharmaceutical firm faced claims from mothers whose babies had been born with disabilities attributable to thalidomide, a drug which it had distributed in Australia. Its liability policy with the defendant insurer included a cap on liability for any series of claims, and a "no settlements without consent" clause. The insurer did not decline liability when notified of the claims. Rather, it sought declarations as to the scope of its liability. By acting in this way it forced the insured to defend claims that the insured would rather settle. But the High Court of Australia found that the insurer was not in breach of contract. It was not contractually obliged to come in and defend the claims; it had the right to wait until the insured's legal

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70 At 615.
71 At 611.
72 Derrington and Ashton, above n 46, at 3093–3094.
73 *Paper Reclaim Ltd v Aotearoa International Ltd* [2007] NZSC 26, [2007] 3 NZLR 169 at [18]; and *Kumar v Station Properties Ltd* [2015] NZSC 34, [2016] 1 NZLR 99 at [63].
74 See the thorough survey of the cases in Marshall and Potts, above n 65.
75 *D A Constable Syndicate 386 v Auckland District Law Society Inc* [2010] NZCA 237, [2010] 3 NZLR 23 at [84].

liability was established.[76] Gibbs and Stephen JJ recognised that, as held in *General Omnibus*, an insurer in such a case may be in breach of contract where it has specifically denied any liability to indemnify when notified of a claim.[77]

[100] In *Mainfreight* this Court adopted counsel's characterisation of such behaviour by an insurer as an "anticipatory" breach of contract.[78] Put another way, the insurer is in breach because it has declined the claim (as it turns out, incorrectly) following notice, thereby notifying the insured that it will not indemnify the insured when the latter's liability is established. The consequence is that the insurer is liable for damages flowing from the breach and the insured may recover amounts which under the policy could have been recovered only with the consent of the insurer. The insurer may be taken to have waived its right to withhold consent or to participate in the settlement.[79]

[101] The rationale for holding an insurer liable for a sum paid by the insured to settle a third party claim was examined in *Unity Insurance Brokers v Rocco Pezzano*. This was not an indemnity case.[80] The defendant was not an insurer but a broker, and it breached not a contract of indemnity but an obligation, as an agent, to arrange such a contract. For our purposes the decision establishes that settlement of third party claims resulting from a breach of contract may have been within the contemplation of the contracting parties.[81] This is a straightforward application of the rule in *Hadley v Baxendale*.[82] However, Gummow J also considered the insurance cases, extracting

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76 *Distillers Company Bio-chemicals (Australia) Pty v Ajax Insurance Co Ltd*, above n 65, at 26 per Stephen J.

77 At 13 per Gibbs J and 27–28 per Stephen J respectively. Stephen J distinguished North American authorities in which the insurer was contractually obliged to come in and defend claims: see 27.

78 *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd*, above n 59, at 77,975, citing KCT Sutton *Sutton's Insurance Law in Australia* (2nd ed, Law Book Co, Sydney, 1991) at [15.32]. In *Edwards v Insurance Office of Australia Ltd*, above n 64, at 98, Halse Rogers J characterised the insurer's wrongful refusal to accept liability in reliance on an exclusion as "practically an anticipatory breach of contract".

79 As this Court recognised in *D A Constable Syndicate 386 v Auckland District Law Society*, above n 75, at [84]. In *CGU Insurance Ltd v AMP Financial Planning Ltd* [2007] HCA 36, (2007) 235 CLR 1 the insurer advised the insured that it should act as a prudent uninsured. Gleeson CJ and Crennan J held that an estoppel precluded the insurer from denying liability to indemnify the insured for any payment made under a settlement, policy conditions to the contrary notwithstanding.

80 *Unity Insurance Brokers v Rocco Pezzano*, above n 62, at [58] per Gummow J. For that reason, it was held not to be within the reasonable contemplation of the parties that the measure of the broker's liability would be determined by the insured and the insurer: see [68].

81 At [33] per MJcHugh J, [67]–[68] per Gummow J and at [119] per Hayne J.

82 *Hadley v Baxendale* (1854) 9 Exch 341 at 354, [1843-60] All ER Rep 461 at 465 (Exch).

from them the proposition that as between insurer and insured, the latter must mitigate its damages and must pursue a reasonable opportunity of compromise of third-party claims for which the insurer has refused indemnity.[83] It follows from the obligation to mitigate that the liability of the insurer to the insured may be established by a reasonable settlement between the insured and the third party.[84]

[102] The rule was put in this way in *GRE Insurance Ltd v QBE Insurance Ltd*:[85]

> A right to recover from another in respect of payment of a liability usually includes the right to recover for an amount not proved to have been due, but reasonably and honestly paid where doubt existed as to the liability or its extent.

[103] To the same effect Halse Rogers J held nearly 50 years earlier, in *Edwards*:[86]

> … the plaintiff, having been put in the position of having to take all steps in connection with the litigation of the claims against him at his own risk, is entitled to recover, as damages, such sums as he paid to settle those actions, provided that he shows that he acted reasonably in making the settlement.

[104] What must be proved to engage the rule that an insurer is liable to pay the amount of the insured's settlement with the third party? Derrington and Ashton state that:[87]

> If the insurer is in error in refusing indemnity, it is necessary for the insured to show only that it was reasonable to settle and that the amount of the settlement was reasonable. If this is followed, the settlement establishes the 'liability' of the insured within the meaning of the covering clause of the policy ... If he relies on this to prove his liability and its amount, he must prove the insurer's conduct which entitled him to pursue the settlement, that the claim came within the policy's cover, that he entered into the settlement as the result, and that the settlement was reasonable in the sense that it reflected his informed and good faith effort to resolve the claim.

[105] Accordingly, the insured having shown that its liability was covered and the insurer having failed to show that an exclusion applied, the insured is entitled to

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83 *Unity Insurance Brokers v Rocco Pezzano*, above n 62, at [59]–[64].

84 This Court noted in *D A Constable v Auckland District Law Society*, above n 75, at [84]–[85] that the rule that the insurer's breach confers on the insured a right to act reasonably in its own interest might be conceptualised in a number of ways. In *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd*, above n 59, the Court suggested that the insured's duty to settle on reasonable terms reflects the good faith required of a party to an insurance contract: at 77,976.

85 *GRE Insurance Ltd v QBE Insurance Ltd* [1985] VR 83 (VSC).

86 *Edwards v Insurance Office of Australia Ltd*, above n 64, at 98.

87 Derrington and Ashton, above n 46, at 1465 (footnotes omitted).

damages and the settlement sum may establish both the underlying third-party liability and the measure of loss. The question is whether it was objectively reasonable to settle and whether the settlement negotiated was honest and objectively reasonable.

[106] Mr Ring invited us to discard this rule. He argued that an insured must prove its at-trial insured liability, meaning its actual liability to the third party, and will recover the full amount of the settlement sum only if it was less than or equal to the at-trial liability. In this case, because the Council allegedly recognised that the settlement sum exceeded its at-trial insured liability, the Council must prove that part of the settlement sum was reasonably attributable to the insured liability. For this he cited dicta of Aitkens J in *Enterprise Oil Ltd v Strand Insurance Co Ltd*.[88] The facts were uncommon; the insured reached a settlement in Texas having been sued for tortious interference with a contract. Aitkens J decided as a matter of English law that on the true construction of the insurance contract the plaintiff was entitled to indemnity only if it proved it was actually liable to the third party under Texas law. This it failed to do. But the Judge added that generally speaking, an insured could not rely on the settlement; under a liability policy it must prove that it was or would have been liable for at least the amount of the settlement.[89] If the settlement sum exceeded at-trial liability, it must be apportioned.[90]

[107] We accept that an insured may be obliged by the terms of the policy to prove its at-trial liability to the third party. But where the policy does not so provide, as in this case, the rule is as we have explained above: a reasonable settlement of the third-party claim crystallises the loss for which the insured is entitled to indemnity.[91] It is a sufficient rationale that such settlement is within the reasonable contemplation of the parties as a consequence of the insurer's breach of contract.[92] This we take to

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88 *Enterprise Oil Ltd v Stand Insurance Co Ltd* [2006] EWHC 58 (Comm), [2006] 1 Lloyd's Rep 500.

89 At [27], citing *MDIS Ltd v Swinbank* [1999] 2 All ER (Comm) 722 (CA) at [11]; and *Structural Polymer Systems Ltd v Brown* [2000] Lloyd's Rep IR 64 at 72.

90 The judgment was cited for this proposition by MacKenzie J in *Arrow International Ltd v QBE Insurance (International) Ltd* [2009] 3 NZLR 650 (HC) at [93]–[94].

91 We observe that in Marshall and Potts, above n 65, at 141 it was argued that the authorities relied upon by Aitkens J in *Enterprise Oil* did not support his conclusion.

92 *BNP Paribas v Pacific Carriers Ltd* [2005] NSWCA 72 at [13] per Handley JA and [187] per Giles JA

be settled law. In *BNP Paribas v Pacific Carriers Ltd* Giles JA summarised the position in this way:

> [187] At least where the insurer has breached the contract by denying liability, the weight of authority in the indemnity cases is that the insured can recover the amount of a reasonable settlement from the insurer … This is consistent with the reasoning in *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* in that, on the application of principles concerning causation and remoteness in assessment of damages, settlement will commonly be causally related to the insurer's breach and a natural and reasonably contemplated result of the breach. As McHugh J said in *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* at [33], "As a general rule, a contract breaker must be taken to have reasonably contemplated that its breach may force the innocent part into litigation with third parties and that the innocent party may conclude that it is in its best interests to compromise the third party's claim".

To those authorities we add this Court's decisions in *Mainfreight* and *D A Constable*.[93]

[108] We record for completeness that Grice J recorded RiskPool's acceptance that a judgment on the plaintiff's claim was not required and a negotiated settlement would qualify for cover.[94] We assume that what RiskPool intended by this concession was that a settlement sum may be recovered where the insured shows that the payment met or exceeded its at-trial insured liability. She added that the general indemnity does not require that legal liability be established.[95] We accept Mr Ring's submission that she was wrong about the latter point; this is a liability policy. A qualifying settlement establishes and quantifies the insured's liability to the third party.

Application of these principles to this case

[109] As noted earlier when discussing the Protection Wording, RiskPool indemnified the Council for Claims by a third party for breach of a legal duty of care arising from its negligence. Under the heading "Claims Procedure" the Wording specified that the Council must give notice to RiskPool as soon as practicable of any claim or intimation of a claim. There was a "no settlement without consent" clause: the Council could not admit liability or settle or promise any payment, or incur costs, in connection with a Claim without RiskPool's written consent and RiskPool might at

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93 *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd*, above n 59; and *D A Constable v Auckland District Law Society*, above n 75.

94 Judgment under appeal, above n 1, at [351].

95 At [351].

its option take over and conduct the defence and/or settlement of any Claim. A QC clause provided that neither the Council nor RiskPool need contest any legal proceedings unless a Queen's Counsel advised accordingly. For present purposes the Wording is not materially different (so far as we can gauge from the reports) from the policies in the indemnity cases discussed above.

[110] It might seem to go without saying that RiskPool is in breach of contract. It declined cover, reasoning that Exclusion 13 applied to exclude liability for the Waterfront plaintiffs' Claims in their entirety. In its statement of defence it admitted that it had denied liability to indemnify the Council.

[111] However, in argument before us Mr Ring argued that RiskPool has done no more than delay its decision to indemnify until its liability in law is finally established. It had taken a good-faith view of its obligations. It pleaded that if, contrary to its denial, it was liable to indemnify, the Council must prove its at-trial liability to the Waterfront plaintiffs or, if it could not do that, that the settlement sum was a reasonable sum to pay having regard to its at-trial liability. It further pleaded that despite its denial of liability it remains willing to perform its contractual obligations in accordance with the proper interpretation of the Wording. In support of this argument Mr Ring cited correspondence between the parties in which RiskPool initially reserved its position then denied liability while, in his submission, retaining an open mind. He argued that RiskPool genuinely intended to consider the Council's request for indemnity, "remained open to reconsidering" based on anything the Council wanted to say, and was "ready and willing" to indemnify to the extent required by Exclusion 13.

[112] We do not think the question is whether RiskPool acted in good faith (and we are content to assume that it did). The question is whether it denied liability, so forcing the Council to act as if uninsured. We find that RiskPool unmistakeably did that. In an email of 6 November 2014, it stated that "any claim by Council on [R]iskpool for this property is subject to Exclusion 13a …". That remained its position. It did not come in and defend the Claims. It did not take control of the settlement (though it did request that it be permitted to attend the mediation; the Council refused). We do not accept that it was open to persuasion. Its "willingness" to reconsider was and remains

conditional on it being compelled to pay following a finding in this proceeding that it is liable to indemnify.

[113] RiskPool's denial of breach invites comparison with the insurer in *Distillers*.[96] The insured in that case faced a series of claims which, it seems, would not all be resolved before its liability was settled in the declaratory proceedings. The High Court of Australia appears to have understood that it might engage with the claims (for which proceedings were pending) in the meantime; some of the judgments discuss whether it must act reasonably when consenting to any admission or settlement. RiskPool had the same right to delay indemnifying the Council until the third-party liability was established. It might (subject to the QC clause) insist on the Council going to trial. But it did not suspend its decision on the Claims until its liability to pay was established in declaratory proceedings preceding trial of the Waterfront plaintiffs' claim. On the contrary, it declined indemnity, contemplating that its liability would be established after judgment or settlement in that proceeding. Indeed, it contends that it ought to have been joined as a third party so its liability to the Council could be established at the same time as that of the Council to the plaintiffs.

[114] We accept that RiskPool did not repudiate the entire contract, as it might have done (by way of hypothetical example) for material nondisclosure or fraud.[97] That would require an unequivocal intention not to perform the contract, which is hardly consistent with RiskPool's insistence that it could invoke an exclusion clause found there.[98] We accept too that insurance contracts do not fall into a special class. But as we have explained, the fallacy in RiskPool's argument is that repudiation must mean repudiation of the entire contract, for purposes of s 36 of the Contract and Commercial Law Act 2017. The authorities were mostly decided at common law and they do not use the term in that sense.[99] They use it rather to indicate that the insurer is in breach of contract if, having been given notice of a claim, it makes clear that it

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96 *Distillers Company Bio-chemicals (Australia) Pty v Ajax Insurance Co Ltd*, above n 67.

97 *Kumar v Station Properties*, above n 73, at [55]–[58]. Whether RiskPool's conduct might be characterised as a "partial repudiation" entitling the Council to cancel the contract is not in issue.

98 At [63].

99 This was the position adopted in Nigel G Rein "Liability Policies: The Relationship of the Claim against the Insured and the Insured's Claim on the Insurer" (1994) 6 ILJ 193 at 221.

will not indemnify the insured. We find that RiskPool's conduct was a "repudiation" in that sense.

[115] It follows that, having declined indemnity, RiskPool was in breach of contract, because its interpretation of the exclusion was wrong in law.

[116] The Council pleaded the breach, alleging that RiskPool had denied liability in reliance on Exclusion 13. It sought recovery of the settlement sum with defence costs and expenses. In its reply to the amended statement of defence it pleaded that RiskPool had denied liability and such denial amounted to a repudiation of liability to indemnify. This was not, as Mr Ring contended, a claim for indemnity under the Protection Wording. It was a claim for damages for breach of contract, albeit the measure of loss was the same.

[117] We add that there is something in Mr McLellan's point that the distinction between pursuing an indemnity under the contract and seeking damages for breach of it may be less consequential than first seems. It would matter if RiskPool sought to rely on contractual claims procedures or some limitation (other than Exclusion 13) in the Wording. But RiskPool did not do that. In particular, it did not attempt to invoke the "no settlement without consent" clause and must be taken to have waived compliance with it. We did not understand Mr Ring to dispute that the Council was placed in the position of a prudent uninsured, forced to go to trial or settle and entitled to act in its own best interests. He accepted that it acted reasonably in deciding to settle with the Waterfront plaintiffs.

[118] In the result, the Council need not prove that it would have been liable to the Waterfront plaintiffs for an insured loss, and in what sum. As we have explained, and as this Court previously held in *Mainfreight*, the question is whether it acted reasonably in settling the third-party claims.[100]

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[100] *Royal Insurance Fire & General (NZ) Ltd v Mainfreight Transport Ltd*, above n 59, at 77,976.

What may be proved, and by whom?

[119] The initial onus is on the insured to prove the settlement's reasonableness. There is a relationship between the Council's at-trial liability and the reasonableness of its settlement. Just how closely the settlement sum must correspond to at-trial liability must depend on the particular circumstances. Generally, a settlement is reasonable if, judged objectively, it is made to compensate the claimant for the value of the claim, by reference to its prospects of success. The assessment of reasonableness must be based on information, which may have been incomplete or imperfect, that was available at the time of settlement.[101] To this end evidence may be led about the settlement process.

[120] Where, as in this case, the claim is mixed in the sense that only part of it is covered, the insured must also prove the allocation of that part of the settlement within the cover, and its reasonableness.[102] Mr McLellan resisted this conclusion. The Council's position is that because it relies on an exclusion RiskPool must prove what part of the settlement sum is excluded.[103] We do not agree. The issue is not proof of the underlying exclusion (which would lie on the insurer) but reasonableness of the settlement by reference to insured liability. And as a practical matter, we do not understand there to be any remaining dispute about classification of defects as excluded or not. RiskPool's principal point is a different one; it maintains that part of the settlement sum ought to be deducted, *before* apportionment between insured and excluded causes, on the ground that the Council was not liable to pay for certain defects at all.

[121] The leading New Zealand authority on apportionment is *Arrow International Ltd v QBE Insurance (International) Ltd*, a decision of MacKenzie J.[104] In a leaky building case a global settlement had been reached between the insured, a design and build contractor, and the third party. The insured claimed on a liability policy. The trial issue was whether physical loss or damage to the property had happened before the relevant period of insurance. The insurer succeeded on that ground, with the result

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101 Derrington and Ashton, above n 46, at [8.521] and [13.214].
102 At [13.212]–[13.214].
103 At [10.28].
104 *Arrow International Ltd v QBE Insurance (International) Ltd*, above n 90.

that cover was excluded,[105] but the Judge went on to consider whether and to what extent a defective products exclusion applied. The insured contended that the settlement sum should be apportioned rateably between covered and excluded items, while the insurer argued for a more targeted assessment which excluded items that were less likely to succeed at a trial of the third-party claim. MacKenzie J correctly accepted, citing *Enterprise Oil* on this point, that a global settlement does not preclude recovery of part of the settlement sum from an insurer. Rather, an apportionment is necessary.[106] It was appropriate to examine the settlement negotiations for that purpose. On the facts, he found that claims for exemplary damages and stigma damages were discounted by the insured in reaching the settlement figure and the documentary evidence suggested that the plaintiffs also entirely discounted those items. Accordingly, it would be artificial to attribute any part of the settlement sum to either exemplary or stigma damages.[107]

[122] MacKenzie J did not need to decide how the apportionment would work, but he appeared to accept the insurer's suggestion that the third-party claims for exemplary and stigma damages and certain other items would be deducted from the settlement sum and the balance apportioned between insured and excluded items.[108] Counsel for the insured evidently did not argue the excluded items ought to have been deducted not from the settlement sum but from the plaintiff's claim. The report does not disclose the amount of the plaintiffs' claims against the insured and it seems the reasonableness of the global settlement sum of $3.78 million was not in dispute.

[123] The settlement being prima facie reasonable, an evidential burden of proving that it was not may shift to the insurer.[109] Mr Ring accepted generally that it is for the defendant to show that something done in mitigation was not reasonable. It may do so by showing, by reference to information available at the time, that the cost of the insured liability was less than the amount paid for it in settlement or that the insured was not in fact liable to the third party.[110]

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105 At [86].
106 At [93]–[94], citing *Enterprise Oil*, above n 88.
107 At [94].
108 At [95].
109 Derrington and Ashton, above n 46, at 3125.
110 *BNP Paribas v Pacific Carriers Ltd*, above n 92, at [231] and [263] .

[124] Grice J accepted that the question is whether the insured acted reasonably in settling,[111] but it is not entirely clear what approach the Judge took to distribution of the onus of proof, which is a matter of considerable practical importance. She stated that she followed *Arrow International*,[112] and she excluded items that she found the parties to the settlement had discounted and examined other items with a view to deciding how the balance of the settlement sum should be apportioned. Because it was not necessary to effect an apportionment given her view of liability, she understandably did not work the apportionment through but indicated that she would have left the detailed calculations to the parties in the first instance, with leave to apply.[113]

Reasonableness of the overall settlement in this case

[125] The Waterfront plaintiffs alleged 22 defects. For our purposes they can be grouped as follows:

(a) Defects 1–12 were all weathertightness defects, typically alleging that a membrane or junction did not prevent water ingress. The only one which merits specific mention is defect 2, alleging that roofs and internal gutters on the main roof did not shed water. It is relevant because, as we discuss below, the Judge found that it had been excluded in the settlement negotiations as a defect for which the Council was not liable.[114]

(b) Defects 13 and 14 concerned bathrooms; these were treated as non-weathertightness defects. We record that Mr Ring contended they might have been treated as weathertightness defects, but did not press the point before us. The Judge found that parties also excluded these defects in the settlement negotiations.[115]

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111 Judgment under appeal, above n 1, at [357]–[359].
112 At [392].
113 At [438].
114 At [415].
115 At [416].

(c) Defects 15–19 concerned fire safety compliance issues. RiskPool sought to exclude these defects not on the merits but on the basis that the Council had relied on hearsay evidence to prove its at-trial liability. The Judge found the evidence admissible to prove the settlement reasonable and categorised them as non-weathertightness defects which were reasonably included.[116]

(d) Defects 20 and 21 concerned passive fire-related defects on northern decks; these the Judge excluded on the basis that they would have been repaired as part of remedial work to repair weathertightness defects.[117]

(e) Defect 22, which alleged that the southern wall of each block had a more than low probability of becoming unstable during a wind event. This was a non-weathertightness defect. The Judge found that it too had been excluded by the parties in the settlement negotiations.[118]

[126] The Council instructed experts to investigate and quantify the defects, and we do not understand it to be in dispute that its advice from experts and lawyers was that it was exposed to liability for the majority of the claims and, due to the joint and several nature of its liability, would likely pay a disproportionate share of the eventual liability.

[127] The Waterfront plaintiffs claimed about $20 million of which $16.2 million comprised costs of remediation. It is the latter sum which the Judge and counsel took to be relevant when assessing reasonableness.[119]

[128] At mediation the Council agreed to pay $12.355 million of a total settlement of $13.65 million. It had authorised a settlement of up to $15 million, expecting that $4 million might be contributed by other jointly and severally liable defendants. The relatively modest contribution from other defendants is explained by their limited capacity to pay.

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116 At [422]–[429].
117 At [430]–[431].
118 At [416].
119 At [416].

[129] The total settlement sum was a global figure. The parties did not differentiate among defendants or defects.

[130] Mr Ring accepted that the overall settlement amount payable by the Council was reasonable at a general level. He focused his argument on the apportionment of the overall settlement between insured liabilities on the one hand, and those that were uninsured or ought to be excluded from the settlement on the other.

Deductions and apportionment

[131] In this section of the judgment we address:

(a) the Council's contention that the Judge wrongly deducted $3.5 million from the settlement sum for defects 2, 13, 14 and 22;

(b) RiskPool's contention that she was wrong to include in the reasonable settlement sum the cost of repairing non-defects, meaning defects that were not pursued by the plaintiffs but whose cost of repair were not deducted from the sum claimed; and

(c) What is to be done now about apportionment in light of our findings and those of the Judge.

[132] We bear in mind that on the first two of these issues the onus of showing the Judge was wrong rests with the Council and RiskPool respectively.

Deduction of $3.5 million for defects 2, 13–14 and 22

[133] Before the mediation the Council's experts advised that they considered it had no liability for these defects and recommended that $3.7 million be deducted for the costs of repairing them. This sum included $2.2 million for defect 22 alone. When added to certain other deductions, this meant settlement might be possible for $15 million, though it depended on the plaintiffs' analysis and the level to which they were willing to compromise at mediation.

[134] At the mediation the Council argued that it was not liable for these defects, but the plaintiffs did not agree. The Council's lawyer, Helen Rice, deposed that the plaintiffs were "largely unmoved" by the Council's arguments and the parties "didn't look at it on a defect by defect basis". Their objective, which Mr Ring explained is typical in such cases, was that of recovering as much as possible of their actual spend on remediation.

[135] Grice J found that:

> [415] I am satisfied on the evidence that the NCC negotiated deductions from the remedial cost claims at the mediation, in the vicinity of somewhere between $3.3 and $3.8m. I accept that a figure in that range was deducted during the settlement negotiations for defects 2, 13, 14 and 22. This was a reasonable deduction. The NCC had received expert and legal advice. Ms Rice is a highly experienced lawyer in the area of building defect claims and her advice would have been influential in reaching the settlement figure.
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> [416] I am satisfied that a deduction of $3.5m, being in the mid-range of the specified defect deductions and including the $500,000 allowance for the non-claiming units, was reasonable. I am satisfied that NCC would have refused to pay the claims for the liability of defects 13–14 and 22 and for the non-claiming units.

(The omission of defect 2 in [416] appears to be a mistake.)

[136] As the Judge went on to say, this was based on the deductions notionally made by the Council for the purpose of settlement.[120] Mr Tompkins for the appellant argued that the finding was unjustified. The Council refused to accept liability for any defects, settling without admission of liability, and the plaintiffs never conceded the disputed defects. The settlement was reached through an iterative process of negotiation, involving pragmatic trade-offs that reflected economic factors such as litigation risk, the benefit of swift resolution, and legal costs. The Judge's finding appeared to rest on an apparent co-incidence between costs of repairing these defects, which she found the Waterfront plaintiffs had estimated at $3–3.6 million and the difference between the claimed remedial cost of $16.2 million and what the Council agreed to pay:[121]

> [414] By the time of the mediation, the Waterfront plaintiffs had provided a remedial work cost estimate for defect number 22 of about $2.2m. Therefore, the total for the three sets of defects (2, 13–14 and 22) by the time of the

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120 At [417].
121 Footnote omitted.

> mediation must have been in the region of $3–$3.6m. RiskPool pointed out that the NCC paid almost exactly $3.8m less than the Waterfront plaintiffs' claims for the cost to remedy the defects, which was the figure that the plaintiffs were focused on recovering at the mediation. Mr Ring said the $3.8m figure was made up of $500,000 in relation to the non-claiming units, and $3.3m, which would be the minimum figure for the defects that the Council had been advised that it was not liable for.

[137] We accept that the Judge was in error in drawing the inference that the parties must have agreed to exclude defects 2, 13–14 and 22. The evidence of Ms Rice, which we do not understand to be disputed, is that the plaintiffs did not in fact agree.

[138] The source of the Judge's error appears to have been an estimate of $2.2 million to repair defect 22 alone. She attributed this to the plaintiffs.[122] However, one of the Council's experts, James White, explained that he prepared this estimate at the request of the Council's legal team to pressure other defendants, who were also responsible for those defects, into settling. In fact the Council's estimate of costs for repairing defect 22 was between $198,000 and $230,000, on the assumption that the defects would not be remedied in isolation, and it appears this did not change. The advice which the Council had been given remained that approximately $2 million in total could be attributed to defects 2, 13–14 and 22.

[139] Mr Tompkins submitted, and Mr Ring appeared to agree, that the Judge deducted $3.5 million from the settlement sum to be paid by the Council to establish the amount to be apportioned between insured and excluded items. We have to say that it is not entirely clear to us that this is what the Judge did. In the passages quoted above, she deducted from the plaintiffs' *claim* for remedial work, $16.2 million, a sum for which she found the parties to the settlement had agreed the Council was not liable. This was an appropriate approach when assessing the reasonableness of a settlement (although we have differed from the Judge on the question whether the deduction was agreed in fact).

[140] We are not persuaded that the same deduction should be made from the Council's share of the settlement sum for purposes of calculating liability as between insured and insurer. On the face of it, the deduction of sums for liabilities which the

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[122] At [412].

settlement parties agreed to exclude should result in an overall settlement sum that reasonably reflects the insured's liability to the third party. The only remaining task would be to apportion that sum between covered and excluded liabilities to quantify the insurer's liability to the insured.

[141] The apportionment would likely be done rateably, as MacKenzie J suggested in *Arrow*.[123] It would be for the Council to show what was the value of the total claim and what proportion of that sum should be attributed to covered liabilities. If the insurer contended that some defects were not reasonably included in the settlement the Court might assess them on an item-by-item basis, making any appropriate deductions before apportioning the balance.

[142] By way of illustration, in this case Grice J examined RiskPool's claim that fire safety defects, items 15–19, ought to have been excluded. As noted above, RiskPool actually sought to exclude them on evidential grounds, assuming incorrectly that the Council had to prove its at-trial liability. But suppose RiskPool had persuaded the Judge that the Council was not liable for these defects, and that in consequence they were not reasonably included in the settlement. In that case an adjustment might have been made to the settlement sum before apportionment. A reasonable adjustment need not correspond to the amount the plaintiffs had claimed. It would be commensurate with the impact that these items actually had on the settlement. The court would have to make a reasonable assessment. If the evidence was limited, it might arrive at its decision in what Giles JA described in *BNP Paribas* as a "fairly broad manner".[124]

[143] We have found that defects 2, 13–14 and 22 were not abandoned by the plaintiffs and were included in the settlement sum. To say that is to add weight to the conclusion that the overall settlement sum was reasonable as between insured and third party; the Council faced a potential liability in relation to these defects, contributing to its exposure to remedial costs of $16.2 million. It gave consideration for them in its share of the overall settlement.

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123 *Arrow International Ltd v QBE Insurance (International) Ltd*, above n 90, at [94].
124 *BNP Paribas v Pacific Carriers Ltd*, above n 92, at [263].

Non-deduction for non-defects and non-claiming units

[144] The Judge explained these conclusions and her findings as follows:

> [437] RiskPool pointed to remedial work that was undertaken but for which claims by the Waterfront plaintiffs were not pursued. RiskPool says these should be deducted as RiskPool should not be liable for these. However, these do not seem to have featured in Ms Rice's advice to NCC. I do not consider it is reasonable to deduct them. They would have been caught up in the global settlement figure which was a reasonable approach in the circumstances.

[145] It will be seen that although the Council would not have been held liable for these claims in the Waterfront plaintiffs' proceeding, they were taken into account by the Council for purposes of settlement and would have been caught up in the global settlement figure. The amount involved was approximately $400,000.

[146] Mr Ring argued that these "non-defects" must be taken to have been excluded by the parties to the settlement in the same way as the defects we have just discussed. He accepted that the non-defects did not specifically feature in pre-mediation advice to the Council, but submitted that they did feature in the negotiation and formed part of the Council's claim that a total of more than $5 million could be deducted for items for which it was not liable.

[147] We are not persuaded that the Judge was wrong. These items were included in the scope of works which quantified the Waterfront plaintiffs' claims. There is no evidence that the parties agreed to exclude them. It was reasonable to allow for them as part of an overall settlement.

Apportionment

[148] We have found that defects 2, 13–14 and 22 were included in the settlement sum. The presence of those defects would affect the apportionment between covered and excluded liabilities. Defect 2 is a weathertightness defect, while the others are not.

[149] The Judge's findings with respect to defects 15–21 are not in dispute. Otherwise the apportionment exercise which she contemplated remains to be undertaken.

Disposition

[150] The Council's appeal is allowed, with the consequences specified at [81] and [148] above.

[151] RiskPool's cross-appeal is dismissed, with the consequences specified at [118] and [147] above.

[152] We remit the proceeding to the High Court to fix the amount of RiskPool's liability. We have found the overall settlement was reasonable, but the apportionment remains to be completed in a manner consistent with our findings and those of Grice J.

[153] RiskPool must pay the Council one set of costs for a complex appeal on a band B basis, with usual disbursements on the appeal and cross-appeal. We certify for second counsel. The costs order made in the High Court is quashed. Costs in the High Court are to be fixed there.

[154] This judgment contains information that was treated as confidential in the High Court as pertaining to the settlement in the Waterfront Proceeding or as subject to privilege which had been waived for limited purposes. Neither party now seeks confidentiality, and no orders are made. We agree with counsel, who have filed a joint memorandum, that the interests of justice no longer warrant confidentiality and that material parts of this Court's reasoning will be difficult to understand if monetary amounts and proportions are redacted.

Solicitors:
Wilson Harle, Auckland for Appellant
Young Hunter Lawyers, Christchurch for Respondent