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To: Finance and Expenditure Committee

Submission on Natural Hazards Insurance Bill – May 2022

Introduction

This submission is from Chapman Tripp, Lawyers, PO Box 993, Wellington 6140. It relates to the Natural Hazards Insurance Bill (*the Bill*).

We would like to make an oral submission.

Our initial contact is John Knight.

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About Chapman Tripp

Chapman Tripp is one of New Zealand's largest corporate law firms. It has a large insurance practice with experience across the full range of insurance law, including law reform and policy development, regulatory and licensing matters, compliance, and resolution of contested insurance claims.

Chapman Tripp were legal advisors to the Earthquake Commission on the Earthquake Commission Act 1993 (*the current Act*) for more than 25 years and including during the Commission's response to the Canterbury and Kaikoura earthquakes.

Our approach to this submission

Chapman Tripp supports the Bill. We recognise that this is an opportunity to learn from previous events, particularly the Canterbury Earthquakes, and to clarify various aspects of the current Act that have resulted in uncertainty and disputes. We support the objectives of this Bill, including enabling better community recovery from natural hazards and clarifying the cover provided by the Bill.

Our submission is focussed on three areas:

- the proposed overarching purpose of the new legislation, the objectives of the Commission and the uses of the Fund
- changes to the Bill which would offer "quick wins" to promote clarity, and
- mechanisms to ensure consistency and certainty in the new regime and reduce disputes.

Room for further improvement

There are some grey areas in the current Act that remain unresolved in the Bill, for example, in relation to the boundaries of the cover provided, such as the interrelationship between land and building cover, and between cover provided by the Bill and cover provided by private insurers. Some of these issues were raised but left unresolved in the litigation brought by IAG and Tower against EQC following the Canterbury earthquakes.

Similarly, there are some complex issues around imminent damage, which are not addressed by the Bill.

These issues may be more complex to address than the "quick wins" we outline in Part 2 of our submission below, but work on these areas would further improve the Bill.

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Part 1 - Overarching purpose; objectives of the Commission; uses of the Fund

The Bill includes new provisions setting out the purpose of the Bill (cl 3), the purpose of the natural hazard insurance (cl 4) and objectives of the Commission (cl 125).

Purpose and objectives provisions can provide useful structure to the legislation and guidance to the Commission in the exercise of its operations. However, it is important to ensure that they are sufficiently broad for the range of functions that the Commission is intended to carry out.

Purpose provisions are used by the Courts to interpret operative provisions in legislation, potentially constraining or otherwise changing their apparent meaning.[1] It is therefore important to consider how a purpose provision may affect interpretation of operative provisions of the Bill.

In our view, there are some instances where the purpose and objective provisions of the Bill are too constrained and do not recognise the intended scope of the function. A similar issue arises in relation to the uses of the Fund, which appear to be narrower than the Commission's functions in some respects.

Examples

1. Purpose does not adequately recognise research function

The proposed purpose and objectives relating to research are narrower than the Commission's functions, both as defined in the current Act (s 5(1)(e)) and in the Bill (cl 126(e) and (f)) so may constrain the Commission's exercise of these functions.

The new functions in cl 126(e) and (f) are appropriately broad and we expect would include the range of research activity currently undertaken by the Commission.

The relevant purpose, on the other hand, primarily cl 3(a)(ii), is focused on community resilience. Our experience is that the Commission has been involved in facilitating research into a broad range of matters, not all of which could be characterised as improving community resilience (cl 3(a)(ii)), or encouraging the availability and uptake of insurance (cl 3(a)(iii)).

The relevant objective in cl 125(2)(c) is also narrower than the function. It provides that the performance of the research functions in cl 126(e) and (f) are to contribute to:

(i) reducing the impact of natural hazard damage:

(ii) improving community resilience to, and recovery from, natural hazards:

(iii) reducing the cost of recovery from natural hazards

[1] See, for example, *Trans-Tasman Resources Ltd v Taranaki-Whanganui Conservation Board* [2021] NZSC 127.

This could be read as constraining the Commission's functions so that it could no longer facilitate research that does not contribute to the above objectives.

Similarly with the provisions relating to the amounts that can be paid out of the Fund. In relation to research, the relevant funding provision is cl 107(c), which provides for expenditure in relation to any other activity in the performance of its functions, but only where:

> the Commission believes on reasonable grounds that the activity has the potential to—
>
> (i) provide a benefit to insured persons; or
>
> (ii) reduce the future cost of providing natural hazard cover.

This appears to be narrower than the corresponding funding provision in s 15 of the current Act, which may mean that the Commission would not be able to fund the same range of research from the Fund as it does currently.

2. Description of purpose of cover for residential land not clear

The purpose provision relating to residential land cover in cl 4(3) creates a number of issues in relation to other clauses in the Bill.

First, cl 4(3) could be interpreted as an additional qualifier to cl 17, to the effect that "*residential land*" is only covered where it "*supports and maintains the integrity and usability of the residential building and access to it*". It may also affect the interpretation of the retaining walls as defined in cl 18(1), which uses similar but not identical language to cl 4.

Cl 4(3) may also be given some weight in considering the interpretation of residential building in cl 9, and the associated definition of appurtenant structure in cl 11, given that one of the consequences of being a residential building is that associated land is covered as residential land.

If cl 4(3) is used as an interpretive tool, the broad language could give rise to uncertainty and disputes as the Commission, private insurers and insured persons work through what is meant by the "*integrity*" and "*usability*" of a residential building and access.

3. Functions should clarify possibility of the Commission becoming centre of excellence within the Pacific or wider

At various times the idea has been mooted that the Commission could act as a centre of excellence with respect to natural hazard risk and insurance and assist our Pacific neighbours (or wider) to develop their own response to these. It is not clear that the functions of the Commission set out at cl 126 (as read in light of the purpose of the Act and the objectives of the Commission – cl 3 and cl 125) are wide enough or are intended to be wide enough to permit the Commission to provide assistance to overseas jurisdictions.

Part 2 - "Quick wins" to promote clarity

We have identified multiple instances where small changes to the Bill would promote clarity and reduce the potential for disputes following future natural hazards.

Some of these may appear unimportant, but in a large event even small matters – such as a definition of fixed carpets and whether a clothes line is an appurtenant structure – can have huge monetary and operational impact across thousands of claims. Improving clarity on such matters can therefore improve customers' experience and allow resources to be focussed on more important issues.

We set out below a number of examples of such matters, though we do not intend this list to be comprehensive.

Examples of "quick wins"

4. Dwelling – cl 6

The definition of a dwelling in cl 6 refers to "*a building, or part of a building*". It is not clear from this whether a dwelling can include a dwelling that is comprised of more than one building.

For example, some dwellings may have an external laundry, kitchen or toilet, and therefore no one building or part of a building would meet the requirement of being a dwelling in cl 6(1)(a) of having "*the facilities necessary for day-to-day living on an indefinite basis (including somewhere to cook, sleep, live, wash, and use a toilet)*".

As a related point, it is also not clear what is meant by the requirement for a dwelling to have "*somewhere to cook*" as part of the necessary facilities for day-to-day living. For example, whether a microwave would be sufficient.

5. Fixed carpets – cl 9(3)(a)

Under cl 9(3)(a), a residential building is defined as including "*fixtures and fittings (such as… fixed carpets)*". It would be useful to provide further clarity on what is meant by "fixed carpets". For example, whether it includes carpets on smooth edge – a carpet edging strip that holds down carpet, or is glue or tacking required.

This is a minor issue but, in a large event, it can cause uncertainty for a large number of customers and is an unnecessary distraction from other work assessing and settling claims.

6. Clothes lines – cl 11 and Sch 2

There has been ongoing uncertainty about whether clothes lines are appurtenant structures under the current Act, which is not resolved in the Bill.

If a clothes line is an appurtenant structure, then it is covered under the current Act, and the Bill, along with 8m of land around the clothes line. The additional land cover in particular can add significantly to claim assessments and settlement

amounts on larger properties, for land that is often far from the house and not important to its use as a residential building. The value of the land affected by this issue in the Canterbury earthquakes would have been in the order of many millions of dollars.

Example 2 under cl 2 of Sch 2 of the Bill, which sets out excluded property, reinforces this uncertainty by starting with "*If a rotary hoist clothes line is an appurtenant structure …*".

Looking at the operational provisions of the Bill (which in this context are not materially different from the current Act), it does not seem likely that clothes lines fall within the appurtenant structures definition in cl 11, in particular cl 11(a)(ii) "*is, or is part of, a separate building or another immovable structure (such as a garage or garden shed)*". Structure in this context would be interpreted by reference to the examples of a garage or garden shed, and a rotary hoist clothes line is not a structure in that sense.

Interpreting appurtenant structures to exclude clothes lines would also be consistent with the purposes of natural hazard cover in cl 4, where the focus is on dwellings and the land needed to support the integrity and usability of residential buildings.

However, regardless of whether it is decided to include or exclude clothes lines, it would be appropriate to provide clarity on this point.

7. Excluded property – cl 1, Sch 2

The wording of cl 1 of Sch 2 relating to excluded property is difficult to follow, and could be clarified:

> Property that would, but for this schedule, be part of a residential building is excluded property if it is not insured under the fire insurance contract for the residential building.

8. Shared, common and joint property – cl 33

We considered how the rules in cl 33 for determining the replacement cost for any damaged shared property, common property or joint property should be applied in a number of scenarios, including:

- service infrastructure for residential buildings off a long private road (or right of way); and
- carparks in an apartment building.

In our view the complexity of scenarios that commonly exist mean that it is either:

- uncertain how EQC cover will apply; and/or
- EQC's response could vary between functionally equivalent scenarios in a way that would not accord with public expectation.

As stated elsewhere in this submission, we consider there is merit in providing regulatory recognition to EQC's Claims Manuals (appropriately updated). This is

particularly so where private insurers settle EQC claims under an agency settlement model.

9. Replacement sum insured – cl 34-36

A definition of "Replacement sum insured" would improve understanding of clauses 34 to 36. For example, cl 34(1) could read:

> This section applies if the fire insurance contract specifies replacement or reinstatement of the residential building up to a maximum specified sum for the residential building or two more sums covering different parts of the residential building (the replacement sum insured)

Clauses 34(3) and 35(3) are the same. We note as a related matter, the words "*a replacement sum insured*" in cl 35(3) should presumably be replaced by "*an amount*".

10. Undepreciated value of retaining walls, bridges and culverts - cl 44

The Bill raises the maximum entitlement for retaining walls, bridges and culverts on an indemnity basis, to provide for cover up to a fixed amount or the "undepreciated value" of the structures (whichever is less).

It appears that the concept of "undepreciated value" is a hangover from the current Act and in our view is unnecessarily complex. Instead, we suggest the reinstatement or replacement cost of the structure is used as the maximum entitlement. This is a better understood concept and will not add materially to the settlement amounts that result, given the fixed amount caps that also apply to these structures.

Under the current Act, retaining walls, bridges and culverts are covered up to their indemnity value. Indemnity value is a commonly used valuation term, which has been interpreted to mean the hypothetical cost of replacing the structure (even if the same structure could not in fact be built now due to Building Act or other requirements), and then depreciated to reflect the age of the structure. "Undepreciated value" in cl 44 is the same hypothetical cost of replacing the old structure, but the costs are not then depreciated.

Undepreciated value is not a commonly used concept and is not necessary. It raises complexities in considering the costs of undertaking work that would not be undertaken (including for example, fees that would be payable "*as if the structure did comply with current building standard*" in cl 44(2)(c)). We suggest it would be simpler to use the reinstatement cost under cl 40 (or, potentially, replacement cost under cl 32).

11. Seven-day damage period – cl 51

Clause 51 provides that all the natural hazard damage that occurs to a residential building, residential land or both during a damage period is the subject of the same claim. However, cl 51 provides two different damage periods for different kinds of natural hazards: a 48-hour damage period for most kinds of natural hazards but a 7-day damage period where the initial damage is the direct result of volcanic activity or a natural hazard fire.

We consider this distinction unnecessarily complicated. Clause 51 could be simplified by providing a single 7-day damage period in all cases. This approach avoids the complication of having to determine which kind of natural hazard the damage was a direct result of. This approach will further help to ease the administrative complexity of claims, an objective recognised in the explanatory note to the Bill.

In addition, this approach reduces the potential for difficulties or disputes about allocating damage, and apportioning settlement amounts, to different damage periods, which will be more acute if a 48-hour rather than a 7-day damage period applies.

In most cases, most, if not all, of the natural hazard damage will occur early in the damage period. Any additional exposure for the Commission by applying a standard 7-day damage period (rather than a 48-hour period) will be minimal, but the change will simplify and improve the claims experience for customers.

12. Requiring Commission to advise if a claim has been accepted as valid – cl 57

Clause 57(1) now requires the Commission to decide whether to accept a claim as valid, or to reject a claim as invalid, as a preliminary decision before then deciding – if it accepts the claim – how to settle the claim. Clause 57(4) requires the Commission to notify the insured person of any decision to *reject* a claim (in whole or in part). However, there is no provision requiring the Commission to notify the insured person of any decision to *accept* their claim.

We consider the customer experience would be improved by requiring the Commission to notify the customer when the Commission had decided that their claim was valid. Such a requirement also provides an appropriate discipline on the Commission to make claim validity decisions appropriately and will encourage the Commission to keep communicating with its customers. However, it should be made clear that any decision to accept a claim is without prejudice to the Commission's power to decline a claim under cl 64.

13. Declining claims and recovering wrongly paid sums – cl 64

Clause 64(2) provides that the Commission may decline the claim "*at any time regardless of any action the Commission has taken towards assessing, deciding, or settling the claim*". Accordingly, there may be cases where the Commission (properly) decides to decline a claim *after* the claim has already been settled and *after* the Commission had already expended money settling the claim to the insured person's benefit.

Recovery by the Commission from the insured person of money expended settling a claim is particularly appropriate where (for example) the claim was fraudulent (cl 69) or the insured person knowingly gave misleading information to the Commission (cl 68). Given the insured person's obligation to provide further information even after claim settlement (cl 56(7)) and the Commission's power to reconsider and change a claim decision in light of new information (cl 55(4)), the Bill could usefully confirm the Commission's power to recover overpayments to insured persons and clarify any defences a customer may raise to such a recovery.

Sections 248 and 251 of the Accident Compensation Act 2001 provide recovery and defence provisions that could be included in the Bill, with appropriate modifications, to clarify this matter.

14. Natural hazard notification on land title – cl 74

Clause 74(1) provides that a claim may be declined if there was a notice on the title of the property that relates to the same natural hazard that resulted in the damage that is the subject of the claim. However, early notices of natural hazards on property titles do not always specify the type of natural hazard. In such cases, it may be difficult – or inappropriate – to apply cl 74. The intended approach in these cases should be clarified.

15. Ambiguity as to when Minister must top up Fund – cl 108

The natural disaster fund was depleted as a result of the Canterbury earthquakes and the question arose whether the Minister should top up the Fund from the point that the Fund was assessed as being insufficient to meet the Commission's obligations (balance sheet insolvency); or only once the Commission became unable to meet obligations as they fell due (cashflow insolvency).

It seems that cl 108 intends cashflow insolvency by reference to "*amounts due and payable*". But the clause does not specify that the Minister's obligation only arises at that point. It could arise at the point when the Commission is predicted to be unable to pay amounts that become due in the future.

We consider that there is merit in permitting the Minister to pay on balance sheet insolvency where that is assessed to best meet the purposes of the Act and to require the Minister to pay if cashflow insolvency occurs.

16. Certification of insurers' levy payment - cl 113

The Bill uses a certification mechanism to confirm that insurers have paid the correct amount of levies. This is similar to the approach originally used for fire service levies, where it was found to have problems and was replaced in 1992 with an auditing regime. If this has not happened already, we recommend that Fire and Emergency New Zealand be consulted as to the relative merits of these systems for ensuring the correct payment of levies.

Clause 113 makes deliberate non-compliance a criminal offence punishable by imprisonment. In our view, imprisonment is an excessive penalty. Financial penalties for the company should be a sufficient incentive for compliance.

17. Mismatch between heading and content of power to charge for continuation of cover – cl 121

This clause provides for payment by the insured person of an amount to be specified in regulations for the "*continuation of natural hazard cover*". However the natural hazard cover continues whether or not any additional amount is paid (cl 29).

Whereas the levy for cover is paid by the insurer, this additional payment is to be paid directly by the insured person (who may be one or more persons e.g. multiple

owners of Māori owned land). In practice, the Commission did not seek payment of additional levies from insured persons after the Canterbury earthquakes.

It is a policy question whether to treat levies as an annual payment for all claims while the fire insurance policy is in force or to provide for additional levy obligations that may not be enforced, or may be enforced inconsistently - e.g. recovered where it is easy by deduction from insurance payments but not recovered where costly enforcement action is required, or where there are multiple liable persons not all of whom can be located.

The clause is also silent as to whether the liability for payment is joint and several or several only and, if the former, whether that person is entitled to recover a contribution from other liable persons.

18. Power to disclose threat information not wide enough – cl 139

The Royal Commission to inquire into the Canterbury Earthquakes recommended that the Earthquake Commission Act be amended to allow for disclosure of information that may affect personal safety, stating:[2]

> It is clearly appropriate and sensible to remove any doubt about the ability to disclose information that might affect personal safety. Our recommended amendment is wider in its terms than that proposed by EQC. We do not think the exception should be limited to cases of "serious and imminent" threats to health and safety. Any threat would be sufficient to justify disclosure.

Consistent with this finding, we recommend that the Commission be empowered to disclose information where it believes on reasonable grounds that doing so is necessary to prevent or lessen any threat to public health or public safety or to the life or health of any individual. The power should not be limited to the defined "serious" threat. The existing definition of serious threat is not comprehensive and the Commission should not be in a position of making fine judgement calls as to whether a threat is sufficiently serious, particularly where there may be some urgency to the decision making.

We recommend that consideration is also given to extending the power directly to officers or employees or agents of the Commission – at least where there is sufficient urgency to make it impractical to refer the decision back to an authorised decision maker at the Commission. This situation seems most likely to arise where an agent of the Commission discovers a threat while in the field inspecting damage.

19. Ambiguous power of disclosure – cl 140(b)

In contrast with the "serious threat" language of cl 139, this clause empowers the Commission to disclose any information where it believes on reasonable grounds that the recipient has a proper interest in receiving it for performing "their functions or exercising their powers".

The clause is ambiguous as to whether the disclosure may be made to a recipient performing the Commission's functions or powers (e.g. to an agent of the

[2] Final report of the Royal Commission, clause 4.25.4.3

Commission) or to a recipient performing the recipient's own functions and powers. This should be clarified. If the intention is to permit disclosure to third parties, it should be made clear the nature of the functions and powers that are relevant to determining whether a disclosure to that third party is permitted.

20. Ministerial directions – cl 128(1)

Before giving a direction under cl 128(1), the Minister is required to "*(if practicable) consult the persons likely to be affected by the direction*". This creates uncertainty about when directions may be given and therefore could be a significant constraint on the use of Ministerial directions.

Ministerial directions are often used in relation to urgent issues, for example in the immediate aftermath of a natural hazard, when there may be uncertainty about whether the test is met but it may not be practicable to consult. This could result in directions not being given when they could have assisted the recovery response.

Ministerial directions in relation to the Canterbury earthquakes included, for example, the Ministerial direction to the Commission to carry out emergency works to repair damage to dangerous or insecure residential premises arising from the 22 February 2011 earthquake.[3]

If this requirement is kept, we suggest it expressly not apply to Ministerial directions in relation to the management of the Fund or the purchase of reinsurance (being directions in relation to the Commission's functions under clauses 126(b) and (d)). For such directions, it would be difficult to identify the "*persons likely to be affected*" in any meaningful way beyond the New Zealand public, and consultation is unlikely to be of benefit.

[3] See Earthquake Commission Annual Report 2010-11 at pages 76-77.

Part 3 - Mechanisms that could be used to promote clarity, consistency and certainty

In reviewing the Bill, we considered what else could be done to give further certainty and to reduce the potential for disputes. While the Bill has gone a long way in seeking to clarify the cover and processes provided in the current Act, the resulting mechanisms are in many cases quite complex. It is inevitable that there will be claims that arise in future natural disaster events that test the application of these mechanisms. The aftermath of the Canterbury earthquakes threw up literally thousands of claims involving complex and unexpected factual situations that tested the operation of the current natural disaster insurance regime. We can see that at least some of these claims would also test the interpretation of the new insurance provisions.

Experience suggests that it is not possible to draft simple, plain English provisions that apply with clarity in all circumstances – or at least no insurer has managed to yet achieve this result.

EQC Claims Manuals

One way to reduce the potential for uncertainty is to provide greater explanation of the way in which the insurance is intended to operate, including by reference to examples. This has already been done for the existing EQC insurance in the form of EQC Claims Manuals (the *Manuals*).[4]

The Manuals are publically available and set out in detail how claims are assessed and settled. The versions of the Manuals currently used were originally drafted by Chapman Tripp in conjunction with EQC with the intention of applying the detailed and extensive learnings from the Canterbury earthquakes. The Manuals provide detail about how the Commission applies the Act in the context of, for example, different forms of damage, and different property ownership situations. The Manuals appear to have been very successful in improving consistency of claim settlements and certainty of customer outcomes.

The Manuals would need to be updated for other changes in the Bill, but once updated would provide useful guidance to insurers and claimants in working through claims. This is particularly important under the current claim management regime where claims are assessed and settled by a range of private insurers. Consistency of expectation and result across these different insurers is imperative.

Some benefit can be obtained from the simple fact of using the Manuals as is done currently. However the position of customers could be further improved by providing formal recognition of the status of the Manuals to ensure that the approach provided by the Manuals is mandated.

Formal recognition of the Manuals

Formal recognition could be achieved in a range of ways. We suggest that the Manuals could be deemed to be determinative of customers' entitlements in the dispute resolution process (but leaving open the possibility of the Manuals being challenged in court

[4] There are two EQC Claims Manuals published on the Commission's website – one for residential buildings and the other for residential land.

proceedings if the customer is not satisfied with the outcome of the dispute resolution process). This would:

- streamline the claim assessment and dispute resolution process for customers, providing a more timely resolution of their claim;
- increase clarity in how the Act will be applied to claims in different circumstances;
- ensure consistency in treatment where multiple private insurers are applying the Act to settle EQC claims under an agency settlement model; and
- provide certainty about the position that the Commission and private insurers will take in applying the Act, including through any dispute resolution process.

If the Manuals were given a formal status, it would also be appropriate to provide a process for their development and approval, in a similar way to the dispute resolution scheme (cl 98) and code of claimants' rights (cl 85) (and other equivalent schemes).

Examples of how giving formal weight to the Manuals would improve clarity, consistency and certainty

21. Shared ownership

As discussed above at example 8 above, there is a range of complex but common scenarios that exist in relation to shared property, common property and joint property that could result in uncertainty or unexpected outcomes under cl 33 of the Bill.

Recognising updated versions of the Manuals would aid understanding and consistency in cover for complex shared ownership properties.

22. Apportionment across multiple events

When multiple events result in damage over a period of time, it may be necessary to allocate damage and apportion settlement payments between different damage periods (see cl 51, discussed above at example 11). This process can give rise to a range of difficulties and potential disputes.

The Manuals could be used to give clarity around the principles that would be applied to determine allocation and apportionment across multiple events, which are relatively settled from previous case law. The Manuals could also elaborate on how the principles would be applied in different factual scenarios and for different forms of damage.

23. Imminent damage

Natural hazard damage in cl 24(1)(b) includes damage that "*in the opinion of the Commission, is imminent…*". There is no definition of imminent, or detail around how the assessment and settlement provisions apply in relation to imminent damage. There can be further complexities around damage that was imminent and then occurs before settlement. The Manuals could give further clarity on these matters.

24. Miscellaneous matters – e.g. clothes lines and carpet

As noted in our above examples, there are numerous smaller matters that are not clear in the current version of the Bill. If these issues are not resolved through the Select Committee process, many of them could be given further clarity through the Manuals. For example, the Manuals could include further guidance on what will be considered an appurtenant structure and what will be included as fixtures and fittings of a residential building.


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