IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

I TE KŌTI MATUA O AOTEAROA
TE WHANGANUI-Ā-TARA ROHE

CIV-2014-485-009933
[2017] NZHC 2901

BETWEEN	WELLINGTON CITY COUNCIL Plaintiff
AND	LOCAL GOVERNMENT MUTUAL FUNDS TRUSTEE LIMITED Defendant

Hearing:	18-22 September 2017 and 25-26 September 2017
Counsel:	D J Goddard QC and S J Fairbrother on 18-22 and 26 September 2017 (with J Shackleton on 25 September 2017) for Plaintiff M G Ring QC with C J Hlavac and K Welsford for Defendant
Judgment:	24 November 2017

JUDGMENT OF COLLINS J

PART I

INTRODUCTION

[1] The New Zealand Mutual Liability Riskpool Scheme (the Scheme) was established to assist local authorities manage their liabilities in an era when local authorities faced increasing accountability for the way they supervised the construction of buildings, and in particular buildings that were found to suffer from leaks (leaky buildings).[1] The defendant, Local Government Mutual Funds Trustee Ltd

[1] For an overview of the liability of local authorities for leaky buildings, and the "leaky building syndrome" see *North Shore City Council v Attorney-General* [2012] NZSC 49, [2012] 3 NZLR

(Riskpool) is the trustee of the Scheme. Riskpool managed a fund under the Scheme to which members contributed. It also negotiated annual reinsurance policies with a reinsurer in London. Local authorities that joined the Scheme were entitled to apply for cover in relation to claims brought against them. The Board of Trustees of Riskpool (the Board) would then decide whether or not to indemnify the local authority.

[2] The Lofts apartments complex (The Lofts) in central Wellington was found to be a leaky building. At that time the Wellington City Council (the Council) was a member of the Scheme. When issues about leaks at The Lofts were brought to the Council's attention in mid-2004 it immediately notified Riskpool of the possibility that it may face a claim. Four years later, the Council left Riskpool and three years after that a civil proceeding (the Lofts proceeding) was commenced in the High Court against the Council and others by the owners of The Lofts, seeking $9.2m in damages largely for the cost of repairing the building.[2] The Lofts proceeding was not brought to Riskpool's attention for another two years, which was nine years and three months after Riskpool was first notified of a possible claim against the Council in relation to The Lofts. A short time after the Lofts proceeding was commenced, Riskpool agreed to commute its reinsurance policies for the fund years ending 30 June 1999 to 30 June 2007 with its reinsurer for $12m, so that, by the time Riskpool learnt of the Lofts proceeding it no longer had any applicable reinsurance cover for the year the Council first gave notice of a possible claim in relation to The Lofts.

[3] After the Lofts proceeding was brought to Riskpool's attention, the Council sought indemnification from Riskpool. The Board declined to indemnify the Council, concluding that the Council had breached a condition precedent to indemnification by the delay in notifying Riskpool of the Lofts proceeding, and that Riskpool had been materially prejudiced by the timing of the notification. The Council now sues Riskpool alleging the Board's decision breached the terms of Riskpool's contract with the Council and, or breached Riskpool's fiduciary obligations to the Council.

---

341 at [1]-[2] per Elias CJ and [92]-[94] per Blanchard J.

2 An amended statement of claim was filed on 30 September 2013 in which $12.2m was sought in damages.

[4] This judgment explains why I am finding against the Council. In particular, I have concluded:

(1) The Council was obliged to notify Riskpool as soon as practicable of the Lofts proceeding when it was served on the Council. "As soon as practicable" meant, in the context of this case, before Riskpool agreed to commute its reinsurance policies.

(2) The Council's failure to notify Riskpool, as soon as practicable, of the Lofts proceeding breached a condition precedent to indemnification.

(3) Riskpool was materially prejudiced by the Council's failure to notify it of the Lofts proceeding before Riskpool agreed to commute its reinsurance policies.

(4) Riskpool acted lawfully when it declined the Council's application for indemnity.

(5) Riskpool had no obligation to provide limited or qualified indemnity to the Council.

[5] To assist in understanding this judgment it has been divided into five parts in addition to this introduction.

[6] Part II sets out the factual background to the dispute. It traverses the documents that govern the Scheme (governing documents), the Lofts proceeding, the decision to commute Riskpool's reinsurance policies and the reasons for the Board's decision not to indemnify the Council.

[7] Part III examines the Council's duty to notify Riskpool, as soon as practicable, of the Lofts proceeding and why its failure to do so breached a condition precedent to indemnification.

[8] Section 9 of the Insurance Law Reform Act 1977 can, in some cases, provide relief to an insured who delays notifying an insurer of a claim. Part IV of this judgment explains why that section is of no assistance to the Council in this case.

[9] Part V explains the duties Riskpool had when considering the Council's application for indemnity and why those duties were not breached in the circumstances of this case.

[10] Part VI sets out my conclusions.

PART II

BACKROUND

The Scheme

[11] The Deed of Trust (the Deed) of the Scheme records that it was established "to benefit residents and ratepayers of New Zealand … by enabling members to be recompensed from the [Scheme] Fund in respect of liabilities thus reducing the need for insurance cover and reducing members' annual expenses".[3]

[12] The purpose in establishing the Scheme was to provide local authorities with cheaper and more effective ways of managing civil claims and liabilities than conventional insurance. This was well-founded during the Scheme's initial years, in the early 2000s, when its membership comprised 83 of the 86 local authorities in New Zealand. In the decade following the establishment of the Scheme, insurance companies started to compete with Riskpool by restructuring their insurance policies in ways that attracted a number of local authorities away from the Scheme. The decline in its membership led to Riskpool's decision to stop providing indemnity under the Scheme for events arising after 30 June 2017. Riskpool may still continue however, to provide cover for members in relation to claims that arose under the Scheme in "fund years" prior to 30 June 2017.[4]

---

3 Deed of Trust, Background cl D.

4 Clause 1.1. A fund year commences at 4.00 pm on 30 June each year and expires at 4.00 pm on 30 June of the following year.

[13] To participate in the Scheme, members make a prescribed payment, innocuously referred to in the governing documents as an "initial contribution", to the Scheme for each fund year.[5] Members in some circumstances can also be called upon to make additional contributions to the Scheme.[6]

[14] The Council became a member of the Scheme at the date of its inception on 1 July 1997 and remained a member until 1 July 2008. Seventy-eight local authorities were members at the time the Council withdrew from the Scheme.

Governing documents

[15] The governing documents of the Scheme comprise the Deed, the Scheme Rules and the Protection Wording for each member for relevant fund years. At times, the Protection Wording is referred to as "Guidelines" or the "Guidelines for the Exercise of Discretion" in the governing documents.

[16] In the event of any conflict between the governing documents, the terms of the Deed prevail over the Scheme Rules and the Scheme Rules prevail over the Protection Wording.[7]

Deed of Trust

[17] The Deed, dated 1 July 1997, was amended by a Deed of Variation of Trust on 22 June 2007. The Deed refers to Riskpool having been established by New Zealand Local Government Insurance Corporation Ltd (LGIC) in consultation with Jardine Risk Consultants Ltd, an insurance broking and risk management consulting services company. Under the Deed Riskpool holds the assets and property of the Scheme in trust for the benefit of its members.[8]

[18] The Deed sets out in detail the purposes and objectives of the Scheme. In addition to the general purpose referred to at [11] above, the Deed explains that the

---

5 Deed of Trust, cl 1.1: "Contribution" includes a member's initial contribution to each annual fund as determined by the Board, pursuant to cl 11 and each additional contribution.
6 Clause 11.3.
7 Clause 14; Scheme Rules, r 3.1.3.
8 Deed of Trust, cls 2.2 and 2.4.

Scheme was established "for the benefit of members"[9] and that the objectives of the Scheme include:

(1) the establishment and maintenance of "an annual fund for each fund year during the term of the Scheme for the benefit of members";[10]

(2) to pay in accordance with terms of the Deed and other governing documents the civil liabilities of members arising from the risks covered by the Scheme so as to reduce the need for members to have insurance cover;[11]

(3) to provide pooled cover for the civil liability risks of members of the Scheme;[12] and

(4) to manage and settle or pay claims made against members.[13]

[19] The Deed provides for the appointment of the Board which in turn appoints a Scheme Manager and a Scheme Solicitor. The Board also determines the duties of the Fund Manager pursuant to cl 10.2 of the Deed.

[20] The Board, which comprises a representative of the Fund Manager; a representative of the Scheme Manager and four representatives of members of the Scheme,[14] is required to implement and achieve the purposes and objectives of the Scheme.[15] Its duties also require it to consider all claims made against the fund and to determine whether or not it should exercise its discretion to meet a member's claim.[16] The Board is required to ensure that the Scheme remains solvent[17] and conduct its business in accordance with the Deed and other governing documents.[18]

---

9 Deed of Trust, cl 2.1.
10 Clause 3.1.1.
11 Clause 3.1.1.
12 Clause 3.1.2.
13 Clause 3.1.3.
14 Clause 5.
15 Clause 6.1.1.
16 Clause 6.1.2.
17 Clause 6.1.3.
18 Clause 6.1.4.

[21] The Fund Manager is required to manage the Scheme fund, which is defined as "all assets and property of the Scheme and includes each separate annual fund".[19] At all relevant times LGIC was the Fund Manager.

[22] On 1 July 2012, LGIC became both the Fund Manager and the Scheme Manager. Mr Sole, who gave evidence in this case, was, at all relevant times, the Chief Executive Officer of LGIC and played a leading role in deciding how LGIC discharged its obligations as both the Fund and Scheme Managers.

[23] Prior to 1 July 2012, Jardine Lloyd Thompson (JLT)[20] was the Scheme Manager. When LGIC became the Fund and Scheme Manager, JLT became the Scheme's Claims Manager. Mr Carpenter, who specialises in local government liability at JLT, played a significant role in deciding how JLT discharged its obligations, first as the Scheme Manager and then as the Claims Manager.

[24] Heaney & Partners[21] is a law firm specialising in insurance litigation. It was appointed by the Board as the Scheme Solicitor.

[25] The Deed provides for the establishment of the fund to meet, amongst other matters, claims by members, the premiums payable to an indemnity insurer or insurers and the operating expenses of the Scheme.[22]

[26] The term "pooled cover" is defined in the Deed to mean cover provided from the fund to manage, and if the claim is accepted, settle claims against a member in respect of "risks",[23] which is in turn defined to mean risks of civil liability of each member that falls within the Protection Wording for a relevant fund year.

[27] Clause 4.2 of the Deed states that each "underlying claim"[24] for risks made by a member during a fund year may be met by Riskpool "at the discretion of the Board".

---

19 Deed of Trust, cl 1.1.

20 Previously known as Jardine Risk Consultants Ltd.

21 Previously known as Heaney & Co. For convenience I will refer to the firm as Heaney & Partners at all times in this judgment.

22 Deed of Trust, cl 4.1.

23 Clause 1.1.

24 An "underlying claim" is defined in cl 1.1 as "any claim for civil liability (covered for the time being under the [Protection Wording]) made against a member which may give rise to a liability;

[28] Clauses 4.2.1 to 4.2.3 provide staged sources from which the Board may make payments to a member. Those staged sources are in the following ascending order:

(1) the pooled cover for a fund year derived from annual funds;

(2) indemnity cover for the relevant fund year;

(3) surpluses from previous fund years;

(4) additional contributions from members; and

(5) guarantees provided by LGIC.

[29] Members' annual contributions are determined by the Board and "held and accounted for as a separate annual fund for that fund year".[25]

[30] Any required additional contributions are paid in proportion to the members' contributions to the annual fund.[26]

[31] Clause 8.2 of the Deed reinforces the discretionary nature of the Board's decision to provide cover. It states:

> The Board shall have absolute and unfettered discretion as to whether or not any claim should be met out of the pooled cover and shall be influenced but not bound by the [Protection Wording].

[32] The Deed prescribes the members' obligations. In particular, members are required to "immediately advise the Scheme Manager of any underlying claim and co-operate with the Scheme Manager and Scheme Solicitor in dealing with underlying claims".[27] Members are also required to "provide the Scheme Manager with all information as is necessary to give effect to the Scheme …"[28] and "disclose all material

---

but also includes a claim which may give rise to a liability to a member under any other category of risk to that member which the [Protection Wording] of the Scheme may properly have been extended to cover pursuant to the terms of this Deed."

25 Clause 4.3.

26 Clause 11.3.

27 Clause 16.2.3.

28 Clause 16.2.

facts to the Scheme Manager as if the member was an insured and the Scheme Manager was an agent for an insurer …"[29]

Scheme Rules

[33] The Scheme Rules are issued each year by the Board. The relevant Scheme Rules were those in force when the Council first gave notice to Riskpool in May 2004 of the issues with The Lofts.

[34] The purpose of the Scheme Rules is to:[30]

> … set out the administrative mechanisms by which Protection Wordings are issued and by which the Scheme is administered so as to put the purpose and intent of the Deed … into effect.

[35] Rule 9 of the Scheme Rules states the Deed and the Scheme Rules "constitute a contract between the Scheme and the Scheme member"[31] and that a Scheme member agrees to be bound by the Deed and Scheme Rules and to "perform the obligations of a Scheme member".[32]

[36] Rule 18 provides that subject to the Deed and the Scheme Rules, the Scheme will, in respect of each fund year, "indemnify each … member against claims for damages or compensation in accordance with the Protection Wording issued to that … member".

[37] Rule 23.1 states a member must, "as soon as possible", give the Scheme Manager written notice "of any occurrence, circumstance, claim, statement of claim, summons or proceedings … or knowledge of any occurrence or circumstances which may subsequently give rise to a claim covered by the Scheme, irrespective of the quantum of such claim".

---

29 Clause 16.2.1.
30 Scheme Rules, r 3.2.
31 Rule 9.1.1.
32 Rule 9.1.2.

[38] Under r 24 a member must provide to the Scheme, the Scheme Manager or any loss adjuster, solicitor or other agent appointed by the Scheme Manager, "all information requested" by or on behalf of the Scheme.

[39] Without limiting the Board's discretion to accept or decline a claim under the Deed, r 27 provides the Scheme will not indemnify a member where the member has:[33]

(1) "breached or failed to comply with any condition or obligation in the Protection Wording issued to the … member or under the Deed ..."; and

(2) the Scheme is prejudiced by that "breach, failure, act or omission".

[40] Under r 21, Riskpool agrees to cover court judgments or settlements approved by the Board in respect of relevant fund years subject to deductions and excesses specified in the relevant Protection Wording. Rules 21.2 and 21.3 of the Scheme Rules substantially reflect cls 4.2 to 4.3 of the Deed and provide for staged sources of payments to members, which are set out at [28] above.

Protection Wording

[41] The Protection Wording for the 2003/2004 fund year is the relevant version for this proceeding. The following conditions are, for convenience, set out in full:

> 2. (a) The member shall as a condition precedent to their rights to be indemnified under this section of the Protection Wording give to the fund as soon as practicable, and during the subsistence of membership, written notice of each of the following:
>
> (i) any claim made against the member;
>
> (ii) any receipt during the period of membership of an intimation, written or oral, from any person of any intention to make a claim against the member.
>
> Such notice having been given to the fund, any claim made pursuant to the intimation shall be deemed for the purpose of this section of the Protection Wording to have been made during the subsistence thereof.

---

[33] Rules 27.1.1 and 27.2.

(b) If during the subsistence of the membership the member shall become aware of any occurrence which may, in the opinion of the fund, subsequently give rise to a claim against it or them for breach of professional duty arising out of any negligent act, error or omission and shall during the subsistence of the membership give written notice to the fund of such occurrence, then any such claim which may subsequently be made against the member arising out of such occurrence shall for the purposes of this Protection Wording be deemed to be made during its subsistence.

…

(d) At the member's own expense, the member shall provide the fund, or legal counsel appointed by the fund on the member's behalf, with all information, including records and statements, and any other information and attend all necessary conferences and court appearances which the fund may require in the course of investigating or defending any claim. The member shall also co-operate with the fund in the defence of any litigation against the member or in the prosecution of any recovery actions instigated by the fund. This is a condition precedent to the member's right to indemnity for any claim.

…

(g) The member shall use due diligence and do all things reasonably practicable to avoid or diminish any loss and shall immediately give all such information and assistance to the fund as the fund may require to enable it to investigate and defend any claim and/or enable the fund to determine liability.

(h) The fund may upon receipt of notice from the member of a claim or a circumstance that might give rise to a claim, take whatever action that it considers appropriate to protect the member's position in respect of any claim against the member and such action by the fund shall not be regarded in any way prejudicing its position and shall not be an admission of the member's entitlement to indemnity under the Protection Wording.

[42] Condition 5 states that the due observance and fulfilment of the terms and conditions of the Protection Wording, insofar as they relate to anything to be done or complied with by the member and the truth of statements in support of a claim, "shall be conditions precedent to any liability of the fund".

[43] In this case, there is no material distinction between the requirements on a member to give Riskpool notice of a claim "as soon as practicable",[34] or, "as soon as possible"[35] or, "immediately".[36]

Reinsurance

[44] In the 2003/2004 fund year Riskpool had two layers of reinsurance cover. The first layer of reinsurance cover was, at the time, with GE Frankona Re for $10m. The second layer of reinsurance was for $40m underwritten by GE Frankona Re (25 per cent), AIG Europe (UK) Ltd (50 per cent) and QBE International Insurance Ltd (25 per cent).

[45] The arrangements were that Riskpool would pay the first $3.5m of aggregated members' claims in the 2003/2004 fund year and GE Frankona Re would indemnify Riskpool for the next $10m of aggregated claims in that fund year. Once this was exhausted, the second layer of reinsurance would be engaged, for the next $40m of aggregated claims in that fund year, in the proportions set out in [44].

[46] In 2006 GE Frankona Re was sold to Swiss Re. By 2011, which, for reasons which will become apparent was a critical year in this case, it was Swiss Re that covered the first layer of Riskpool's reinsurance and 25 per cent of the second layer of reinsurance.

[47] Riskpool's reinsurance cover with GE Frankona Re, in the 2003/2004 fund year, excluded cover for claims lodged with the Weathertight Homes Resolution Service. That exclusion reflected a growing apprehension in the insurance and reinsurance communities with the burgeoning liability of local bodies for leaky buildings in New Zealand. The "leaky building exclusion" changed, when Swiss Re became Riskpool's reinsurer so as to exclude claims for leaky buildings regardless of whether the claim was commenced in the Weathertight Homes Resolution Service or a court. Swiss Re's obligations to cover members' leaky building claims was an ongoing issue between Swiss Re and Riskpool. The parties proceeded on the basis

---

34 Protection Wording, condition 2(a).
35 Scheme Rules, r 23.
36 Deed of Trust, cl 16.2.3.

that in the 2004 fund year there was no exclusion in the reinsurance policy for leaky building proceedings commenced in the High Court.

The Lofts

[48] The Lofts was constructed during 2000 and 2001 on top of an existing building. It comprises over 30 apartments on three levels. Pimento Holdings Ltd (Pimento) was the developer of The Lofts and Mainzeal Property and Construction Ltd (Mainzeal) was the builder. Two street addresses for The Lofts were provided at various stages in the evidence, namely 181 Victoria Street and 185 Victoria Street, Wellington.

[49] On 13 May 2004, the Council became aware of a potential issue, of leaking, at The Lofts. It became aware of this on receiving a request for The Lofts building plans by the Joyce Group, a firm of building consultants who were acting on behalf of The Lofts body corporate. The person making the request identified the street address of The Lofts as 181 Victoria Street and told the Council officer that "all windows" in The Lofts were leaking. The Council officer created an incident report and allocated a complaint file number, which was in turn forwarded to the Council's insurance broker which, coincidentally, was JLT, the Scheme Manager for Riskpool. JLT asked the Council to keep it "informed of any developments in respect of this matter" and forwarded the Council's notification to Riskpool. Riskpool wrote to the Council on 4 June 2004 acknowledging "the notification of a possible claim on Riskpool". The letter from Riskpool to the Council also said that "[a]s it appears likely that this matter will be pursued, we await your keeping us advised, therefore, on further developments".

[50] Riskpool received no further communications from the Council about The Lofts until 26 August 2013. In the meantime, after periodically reviewing its records, Riskpool closed its file on The Lofts in November 2006.

Council withdraws from Riskpool

[51] On 29 June 2007, the Council wrote to Riskpool setting out its concerns about its annual contributions and exposure to additional contributions if it remained a member of Riskpool. After exchanges of correspondence between Riskpool and the

Council concerning the merits of the Scheme, the Council elected to withdraw from Riskpool with effect from 1 July 2008. In its letter explaining its reasons for withdrawal, the Council noted its concerns over the "mutual nature" of the Scheme. The Council said that because of the residual risks of having to make additional contributions it was opting to purchase traditional insurance cover.

The Lofts proceeding

[52] In December 2010, The Lofts body corporate sought a code compliance certificate. The Department of Building and Housing issued a building compliance report in March 2011, which stated The Lofts address as 185 Victoria Street. When the Council searched its records for 185 Victoria Street, it did not locate the 2004 documents.

[53] Having been alerted by the building compliance report to its potential liability, the Council, which by this stage was insured with QBE, sought indemnity. However, in an ironic twist, the Council was advised its insurance did not cover leaky building claims. The Lofts body corporate and owners then instituted proceedings in the Weathertight Homes Tribunal on 12 August 2011. That claim was soon abandoned in favour of a High Court proceeding on 14 September 2011. The proceeding was against the Council, Pimento and Mainzeal and sought $9.2m in damages.

Commutation of Swiss Re's cover

[54] Commutation of reinsurance cover is an agreement between an insured and a reinsurer under which the reinsurer settles in advance, for an agreed sum, all reinsurance claims by the insured for the period of commutation. There are advantages and disadvantages to both parties in commuting reinsurance cover. For the reinsurer there is a risk that it will pay more than it would have been required to pay if the reinsurance cover had remained in place. On the other hand, the reinsurer is effectively "capping" its liabilities. For the insured, there is a risk it will be exposed to claims that exceed the value of the commutation sum. On the other hand, the insurer may "profit" from receiving a commutation payment that exceeds the value of claims for which it is liable.

[55] The possibility of a commutation of Riskpool's reinsurance contract with Swiss Re was first raised in mid-March 2011 when Mr Sole and Mr Carpenter met with representatives of Swiss Re in London. Riskpool's biggest risk of commutation of its reinsurance cover with Swiss Re was that claims against it, in particular, leaky building claims, could become larger and more complex, exposing Riskpool to claims without the benefit of reinsurance cover. This could force Riskpool to call for additional contributions from its decreasing number of members.[37]

[56] The advantages to Riskpool in commuting its reinsurance with Swiss Re were that any ongoing disputes over indemnity for leaky buildings claims, with Swiss Re, would be avoided. Riskpool might also obtain a commutation payment that exceeded its claims liabilities and it would be able to administer claims without having to contend with the ongoing involvement of the reinsurer.

[57] On 1 September 2011, Swiss Re offered to pay Riskpool $12m in full and final settlement of all claims against its reinsurance policies for the fund years ending 30 June 1999 to 30 June 2007. This offer required careful consideration and analysis by Riskpool. The Scheme Manager and the Scheme Solicitor assessed the likely liabilities of Riskpool in relation to unresolved claims for the fund years covered by the offer. As part of this exercise Mr Carpenter and Heaney & Partners reassessed the reserves for each known claim. The assessments made by the Scheme Manager and Scheme Solicitor were then reviewed by Mr Sole.

[58] In a memorandum for the Board, dated 20 September 2011, Mr Sole traversed the advantages and disadvantages of Swiss Re's offer. He explained that the estimated claims that Swiss Re would be liable to indemnify, were $10,033,483 as at 21 July 2011. This figure was based on the reserves set for unresolved claims by Mr Carpenter and Heaney & Partners. In recommending that the Board accept the Swiss Re offer, Mr Sole noted this offer contained a margin or "freeboard" of 19.6 per cent above the reserve estimates of $10,033,483.

[59] Mr Sole's report was considered by the Board by telephone conference on 22 September 2011. The Board resolved to further consider the offer at its meeting

---

[37] By 2011, membership of Riskpool had decreased to 57 local authorities.

scheduled for 3 October 2011. In the meantime, it sought additional information including further examination of the reserves for the fund years covered by the offer. The minutes for this telephone conference show the Board wanted further research to be undertaken in relation to building defect claims that might impact upon the reserves calculated by the Scheme Manager and the Scheme Solicitor.

[60] At its meeting on 3 October 2011, the Board had before it comprehensive reports from Mr Carpenter and Heaney & Partners. In his report, Mr Carpenter noted that there was a potential risk of existing claims becoming more complex and expensive, particularly multi-unit leaky building claims. He observed that the "free board" contained in the offer from Swiss Re may accommodate any "deterioration" in the claimants' position but that he could not assess whether the "free board" could "accommodate systematic deterioration in the litigation environment affecting all open claims". On the other hand, Mr Carpenter said there was a risk that Swiss Re could dispute its liability to indemnify Riskpool for leaky building claims and that as any dispute between Swiss Re and Riskpool would be litigated in London, there were risks and potential costs associated with not accepting the offer from Swiss Re. In his report, Mr Carpenter said "that at $12m, the risks and advantages presented by Swiss Re's commutation offer [were] finely balanced".

[61] Heaney & Partners advised the Board that it had revised the reserves on nine claims in which it represented Riskpool. Heaney & Partners recommended an increase of $3.935m in the total reserves set for those claims, all of which involved leaky buildings. The increase in reserves recommended by Heaney & Partners was based on gross claims and included GST. Mr Sole calculated that the net effect of Heaney & Partners increased reserves on Swiss Re's share of claims was $2.03m.

[62] The Board also received an actuarial analysis from Melville Jessup Weaver, which concluded that Swiss Re's potential liability to Riskpool for the fund years covered by the offer could be $11.8m.

[63] Mr Sole prepared an overview of the reports that had been compiled for the Board for the 3 October 2011 meeting. His memorandum recognised that fixing reserves "was not something that could be done accurately and [that] conceivably

some of the reserves on individual files may be higher than the final amount that will be required". Mr Sole estimated that Swiss Re's share of outstanding indemnity reserves for all open claims on the reserves as at 3 October 2011 was $9.8m.

[64] The Board resolved on 3 October 2011 to accept Swiss Re's offer. As a result, Riskpool and Swiss Re entered into a commutation agreement on 25 October 2011 from which Riskpool received $12m but no longer had reinsurance cover with Swiss Re.

Notification of the Lofts proceeding

[65] In a further coincidence, the Council instructed Heaney & Partners to act for it in the Lofts proceeding. It recommended the Council set a reserve of $2m for the claim. That reserve was set in 2011 with the knowledge that Mainzeal, the builder of The Lofts, was a significant company with a history of settling building claims against it by undertaking remedial work. It was a further unfortunate irony in this case, that Mainzeal was placed into liquidation in February 2013.

[66] As part of the litigation process, the Council undertook a thorough investigation of its records concerning The Lofts. In August 2013, the Council discovered the 2004 incident report that it had created when alerted to the possibility of a claim in relation to leaks at The Lofts. That discovery led to the realisation that Riskpool had been notified in June 2004 of a potential claim against the Council in relation to The Lofts.

[67] On 26 August 2013, Heaney & Partners wrote to Riskpool explaining that the Council had only just discovered that Riskpool had been notified in June 2004 of the possibility of a leaky building claim against the Council in relation to The Lofts. Heaney & Partners pointed out that the allegations in the statement of claim corresponded with the Council's notification to Riskpool in June 2004, particularly in relation to the alleged leaky windows and joinery at The Lofts. Riskpool responded to Heaney & Partners on 27 August 2013 confirming it had been notified in June 2004 of a possible claim against the Council in relation to The Lofts. Riskpool was then asked to consider indemnifying the Council in relation to its liability for the Lofts proceeding.

[68] In its Scheme Solicitor's report for the Board dated 3 October 2013, Heaney & Partners noted that although the Council had not kept Riskpool informed of The Lofts claim, this in itself would not appear to have prejudiced the handling of the claim. However, it said Riskpool "itself may have been prejudiced in that [the] claim was not taken into account when the commutation with reinsurers was negotiated". Heaney & Partners noted that the Council had placed a $2m reserve on The Lofts claim largely because of the involvement and reputation of Mainzeal, which was now in liquidation. Although Pimento was still trading, it was unlikely to be sufficiently solvent to meet any liabilities arising from the Lofts proceeding, therefore, the burden of the Lofts proceeding would, in all likelihood, fall upon the Council. Thus, at the time the Board first became aware of the Lofts proceeding it was apparent that the Council was likely to be facing significant liabilities in relation to the Lofts proceeding.

[69] At its meeting on 3 October 2013, the Board resolved to seek a report from Mr Carpenter setting out the material events and "what advice the [Board] would have received at the time of the commute" if it had known about the Lofts proceeding. The Board also sought advice from Mr Ring QC "on the extent of Riskpool's liability" for the Council's claim for cover for the Lofts proceeding. Mr Carpenter also sought advice from the law firm, Morrison Kent.

[70] The Board minutes for 3 October 2013 further record that the Board resolved:

> To agree with the auditor's recommendation to recognise through the income statement the approx. $2.3m surplus on the 2011 commutation.

Mr Sole explained in his evidence that the $2.3m surplus from the commutation was based on an actuarial assessment undertaken by Melville Jessup Weaver on 30 June 2013 and that there was a 50 per cent probability that the surplus would be more than $2.3m and a 50 per cent probability that it could be less than $2.3m.

[71] At its meeting on 1 November 2013, the Board had before it the following reports and advice relevant to the Council's claim:

(1) legal advice from Morrison Kent dated 14 October 2013;

(2) legal advice from Mr Ring dated 15 October 2013;

(3) a report from Mr Sole dated 18 October 2013;

(4) a report from Ms Brown, a legal officer at Riskpool dated 25 October 2013; and

(5) a report from Mr Carpenter dated 25 October 2013.

[72] The advice from Morrison Kent was that the Council had breached a condition precedent to cover by not notifying Riskpool of the Lofts proceedings until August 2013. Morrison Kent advised that the Protection Wording was a contract of insurance under s 9 of the Insurance Law Reform Act, the relevant provisions of which are explained in further detail in Part IV of this judgment. For present purposes, it is sufficient to note that s 9 may relieve an insured of the consequences of their delay in notifying an insurer of a claim, unless the insurer has been so prejudiced by the failure of the insured that it would be inequitable not to bind the insured to the notification obligation. Morrison Kent advised that as "… Riskpool will be able to demonstrate prejudice of so substantive a nature … the Council's claim may be declined".

[73] Mr Ring's advice was that the Council had breached condition 2(a)(i) of the Protection Wording[38] and that as this was a condition precedent to indemnity, Riskpool was "relieved of any liability for the claim". Mr Ring also thought at that time that s 9 of the Insurance Law Reform Act was engaged. He said:

> Clearly, the counterfactual position is that, if advised in late 2011 of [the Lofts proceeding], Riskpool would have maintained its access to [the] reinsurance funds.

[74] Mr Ring said that this constituted sufficient prejudice to overcome s 9 of the Insurance Law Reform Act and justified Riskpool declining cover to the Council.

[75] Ms Brown's paper summarised the legal advice Riskpool had received and noted that Morrison Kent and Mr Ring were satisfied that Riskpool had been sufficiently prejudiced to justify declining the Council's claim.

---

[38] See [41] above.

[76] Mr Carpenter's report recommended the Board rely on the legal opinions it had obtained and exercise its discretion against any indemnity for the Council's claim.

[77] Mr Sole's report focused on the draft accounts for 30 June 2013 and a possible call for additional contributions from members in April 2015. His report noted:

(1) "The Swiss Re commutation profit estimated at $2.3m (before adjusting for the Lofts' claim and ignoring investment income)" had been incorporated into the draft accounts.

(2) The draft accounts included an additional reserve for the 2004 fund year for $2m for The Lofts claim, which Mr Sole emphasised was only an estimate.

[78] The minutes from the Board meeting of 1 November 2013 record the Board considered the legal advice it had received and that it "determined there is no cover for [the Lofts proceeding] and that Riskpool should write to [the Council] declining the claim". No further details are recorded in the minutes about the Board's decision to decline to indemnify the Council in relation to the Lofts proceeding.

[79] Mr Carpenter and Mr Sole were the only two people present at the 1 November 2013 Board meeting who gave evidence before me. In his closing submissions Mr Goddard QC, counsel for the Council, criticised the absence of any evidence from Board members who may have been able to explain the Board's decision. I address Mr Goddard's concerns in relation to this issue at [88] to [94] below.

[80] Mr Carpenter confirmed that he was not asked to advise the Board in November 2013 what reserve they would have recommended for The Lofts claim had Riskpool been notified of the Lofts proceeding at the time it was considering the Swiss Re commutation offer. Mr Carpenter also confirmed in his evidence that no attempt was made, in the advice received by the Board, to estimate the extent of any prejudice that Riskpool may have suffered by not having notification of the Lofts proceeding prior to entering the commutation agreement with Swiss Re. Mr Carpenter

acknowledged that the Board did not consider the possibility of Riskpool providing a limited or qualified indemnity to the Council.

[81] Mr Sole said in his evidence-in-chief that he could not remember specific details about the Board's discussion concerning the Council's request for indemnity. He did, however, say he could "remember the Board had no doubt that Riskpool had been prejudiced by [the Council's] actions/inactions, that the Board was fully aware that Riskpool had no spare funds for an ex gratia payment to [the Council], and that the idea of a call [on members] either then or later to pay an ex gratia claim to [the Council] had no appeal whatsoever".[39] Like Mr Carpenter, Mr Sole confirmed in cross-examination that the Board did not have before it an analysis of any prejudice that Riskpool may have suffered by the Council's failure to notify Riskpool of the Lofts proceeding in September 2011 and that there was no discussion of limited or qualified indemnity being offered to the Council by Riskpool.

[82] During the course of his cross-examination, Mr Sole raised for the first time two other factors that the Board may have taken into account when declining to provide cover to the Council for the Lofts proceeding. Those factors were the Council's resignation from Riskpool in 2008 and that the Council had received more in cover than it had paid in contributions. Because of the importance of this aspect of Mr Sole's evidence, I set out his cross-examination on this issue in full:[40]

> Q. And it's also likely, isn't it, … that you suggested to the board that the [Council] was no longer a member of the scheme, was a reason to exercise the discretion against it?
>
> A. No, I think that came from the board.
>
> Q. So the board took that view?
>
> A. It was certainly discussed by the board and the decision not to pay The Lofts was a unanimous decision. There wasn't much in favour of paying, given the prejudice, and that was one of the things that the board raised.
>
> Q. So whether it was your idea first or not, what I think you've confirmed is that both you and the board considered that one reason to exercise the discretion against [the Council] was that it ceased to be a member?

---

39 Brief of Evidence of T C Sole, September 2017 at [43].

40 Notes of Evidence at 313, lines 3-25.

A. Well, they took that into account. I personally wouldn't give that a great deal of weight, but it's a fact that something that looked like an ex-gratia payment to an ex-member of a club is a little unusual. The board also took into account that … [the Council] had received well over what it had put into Riskpool at [that] point in time. Now whether they should or shouldn't is for His Honour to determine …

Q. What we're trying to work out is what they did take into account.

A. Well that would be, those are some of the things they took into account, but primarily prejudice. No cover anymore and we didn't know about it. No money from Swiss-Re to cover this risk, so we could cover the risk.

[83] An email, added to the common bundle of documents during the course of the trial, suggests Mr Sole may have been the original source of the proposition that the Board could decline to indemnify the Council because it had left Riskpool. In that email, dated 20 October 2013, from Mr Sole to two Riskpool employees, he referred to the prejudice Riskpool suffered due to the Council's failure to notify it of the Lofts proceeding until August 2013 and the fact that the Council had "stopped supporting Riskpool in 2008" as two distinct reasons for declining to indemnify the Council.

[84] On 19 November 2013, Riskpool wrote to Heaney & Partners declining the Council's application for indemnity in relation to the Lofts proceeding. In its letter, Riskpool explained that had it known of the existence of the Lofts proceeding at the time it negotiated commutation of its reinsurance policies, it would have factored the likely size of the claim into its negotiations with Swiss Re. Riskpool said that the late notification of the Lofts proceeding breached the provisions of the Scheme Rules and Protection Wording, requiring notice to be given as soon as possible of any proceeding. It noted that compliance with cl 2(a)(i) of the Protection Wording was "a condition precedent to Riskpool's liability to provide cover". Riskpool maintained in its letter that if the Council had complied with its notification obligations there would either be reinsurance cover in place or it would have received, as part of its payment from Swiss Re, a sum that could be used to apply to the Lofts proceeding. Riskpool advised that it had been "materially disadvantaged" by the Council's late notification of the Lofts proceeding and that the Council could not be relieved of its breaches by s 9 of the Insurance Law Reform Act.

[85] In a further letter dated 2 December 2013, Riskpool explained an additional ground for the Board's decision, namely, if "the Council's claim was accepted then it may be appropriate for the Board to seek additional contributions from members, which in turn would result in an inequitable outcome for the fund members".

Factual findings concerning the Board's decision

[86] The written materials that I have traversed in [84] and [85] establish that the Board took into account the following factors when declining to cover the Council for the Lofts proceeding:

(1) the Council had breached the notification requirements in the governing documents;

(2) the notification requirement in the Protection Wording was a condition precedent to indemnification;

(3) the delay in notifying Riskpool of the Lofts proceeding had caused it material prejudice because it had entered into the commutation agreement with Swiss Re without knowing about the Lofts proceeding; and

(4) if it were to provide cover to the Council, Riskpool might need to seek additional contributions from its other members.

[87] The evidence from Mr Carpenter and Mr Sole also established that the Board did not attempt to quantify the extent of any prejudice Riskpool had suffered. Nor did the Board contemplate providing limited or qualified indemnity to the Council.

[88] In his closing submissions Mr Goddard said that Mr Sole's cross-examination confirmed the Council's suspicion that factors other than those set out in Riskpool's letters of 19 November 2013 and 2 December 2013 had been taken into account by the Board when it decided not to indemnify the Council. Those factors were that the Council had left Riskpool in 2008 and that the Council had received more in benefits than it had contributed in the time that it was with Riskpool.

[89] Mr Goddard also submitted it was incumbent on Riskpool to have called as witnesses, members of the Board who could have explained what factors the Board took into account when it made its decision on 1 November 2013. Mr Goddard invited me to proceed on the basis that the failure of Board members to give evidence leads to the conclusion that the evidence would not have been helpful to Riskpool.[41]

[90] I am not prepared to draw the inferences urged by Mr Goddard. My reasons for not doing so can be reduced to the following two considerations.

[91] First, the Council pleaded its case and opened on the basis that the factors the Board took into account were those I have summarised at [86]. If the Council suspected there was other relevant evidence in the possession of Riskpool, then it could have taken the basic precaution of administering interrogatories under r 8.34 of the High Court Rules 2016 to determine if other factors influenced the Board's decision. Mr Sole was undoubtedly an honest witness who did not shy away from answering all questions in cross-examination in a direct manner. I am sure that if he had responded to interrogatories on this issue he would have provided honest answers.

[92] Second, Mr Sole made it clear that he did not consider the Council's withdrawal from Riskpool in 2008, or the value of the benefits it received compared to its contributions were relevant to the Board's decision. Whatever Mr Sole thought when he wrote the email to two of his staff on 20 October 2013, his unchallenged evidence before me was that he did not consider it relevant that the Council had left Riskpool in 2008.

[93] It is clear however from the passage of Mr Sole's cross-examination set out at [82] that at least one member of the Board took into account that the Council was no longer a member of Riskpool and that the Council had received more from Riskpool than it had contributed. It is also apparent from Mr Sole's evidence as a whole that the Board's primary consideration was the prejudice it believed Riskpool had suffered as a consequence of the Council's failure to notify Riskpool of the Lofts proceeding prior to Riskpool commuting its reinsurance.

---

41 *Ithaca (Custodians) Ltd v Perry Corp* [2004] 1 NZLR 731 (CA) at [153] and [155]; and *Watson v Watchfinder.co.uk Ltd* [2017] EWHC 1275 (Comm), [2017] Bus LR 1309 at [118] and [119].

[94] In these circumstances, I conclude that the factors referred to by Mr Sole in cross-examination were factors that one or more members of the Board took into account but only in a minor way. These factors did not influence, in any meaningful way, the Board's decision not to indemnify the Council. Had these factors been placed to one side then the Board's decision would have been the same. The overwhelming force of the evidence is that the Board's primary consideration was the prejudice it had suffered because of the Council's delay in notifying it of the Lofts proceeding. The Board was also influenced by its concern about a condition precedent having been breached and the possibility of making calls for additional contributions from members if it indemnified the Council in relation to the Lofts proceeding.

The current proceeding

[95] On 8 May 2014, the Council settled the Lofts proceeding when it agreed to pay The Lofts body corporate members $7,908,000. It incurred costs of $613,738 in settling the Lofts proceeding.

[96] On 1 August 2014, the Council commenced this proceeding against Riskpool. The Council pleads that the amount Riskpool should have paid to the Council had it accepted the Council's claim for cover was $9,684,998.70, calculated as follows:

(1) costs of defending and settling the Lofts proceeding, $8,521,738;

(2) minus the $100,000 excess that would have been deducted under the Scheme Rules;

(3) plus GST of $1,263,260.70.

[97] The Council seeks a declaration that Riskpool has breached its contractual and fiduciary duties to the Council and an award of damages equal to the amount that it would have received in 2013 if Riskpool had acted in accordance with the governing documents.

[98] Alternatively, the Council asks that if it is not possible to determine the amount that it would have received, then damages should be assessed on the basis of its lost

opportunity to have had its claim considered lawfully and in accordance with the governing documents.

[99] It is against this background that I now summarise the principal issues in this proceeding.

Summary of principal issues

[100] It is convenient to analyse the principal issues raised in this proceeding in three parts:

(1) The Council's notice obligations.

(2) Section 9 of the Insurance Law Reform Act.

(3) Riskpool's decision declining indemnity.

[101] Determination of the Council's notice obligations requires an examination of the Council's duty to give notice of a claim, and any ancillary obligations, under the governing documents. If the Council breached its obligations, then the implications of the Council's breach must be considered when considering the Board's decision not to indemnify the Council in relation to the Lofts proceeding.

[102] The issues under the second heading require consideration of whether the Protection Wording issued to the Council by Riskpool for the 2004 fund year was a contract of insurance within the meaning of s 9 of the Insurance Law Reform Act. If it was a contract of insurance, then it would be necessary to consider whether any breaches of the Council's notice obligations could be absolved under s 9.

[103] Assessing the lawfulness of Riskpool's decision to decline to indemnify the Council requires an examination of what contractual and/or fiduciary obligations Riskpool owed the Council and whether Riskpool breached any of these duties when it decided not to indemnify the Council. As part of this analysis I will decide if Riskpool should have considered granting the Council limited or qualified indemnity.

PART III

THE COUNCIL'S NOTICE OBLIGATIONS

Context

[104] It is accepted that in June 2004 the Council gave Riskpool notice of the possibility of a leaky building claim in relation to The Lofts. It is also accepted that on 14 September 2011, the Lofts proceeding was commenced in the High Court and that the Council failed to notify Riskpool of the proceeding until 26 August 2013. In the meantime, Riskpool had, on 25 October 2011, agreed to commute its 1997 to 2007 reinsurance policies with Swiss Re for $12m.

[105] In considering the scope, if any, of the Council's obligations to notify Riskpool of the Lofts proceeding and any other ancillary obligations, I shall first examine the relevant provisions of the governing documents.

Governing documents

Protection Wording

[106] The key provisions of the Protection Wording are set out at [41]. Of central importance are conditions 2(a), (b) and (g). The relevant parts of which are, for convenience, set out again in the following paragraphs.

[107] Condition 2(a) provides:

> … as a condition precedent to their rights to be indemnified [a member shall] … as soon as practicable, … during the subsistence of membership, [give] written notice of each of the following:
>
> (i) any claim made against the member;
>
> (ii) any receipt … of an intimation, written or oral, from any person of any intention to make a claim against the member.

[108] Condition 2(b) relevantly provides:

> If during the subsistence of the membership the member shall become aware of any occurrence which may … subsequently give rise to a claim … [then the member] … shall … give written notice to the fund of such occurrence,

> then any such claim which may subsequently be made against the member arising out of such occurrence shall … be deemed to have been made during its subsistence.

[109] The Council argues that it did not breach the notice obligations in condition 2(a)(i) because it discharged the requirements of both conditions 2(b) and 2(a)(ii) when it notified Riskpool of an intimation of a claim or occurrence in June 2004. Mr Goddard submitted that once the Council gave notice to Riskpool in June 2004 of an "intimation … [of] a claim" or "occurrence" under conditions 2(a)(ii) or (2)(b), its obligations under the Protection Wording were complete. He advanced the argument that condition 2(a)(i) could not possibly impose obligations over and above those in conditions 2(a)(ii) or 2(b) of the Protection Wording because:[42]

> [T]he purpose of condition 2 is to ensure early notification of a claim or of circumstances giving rise to a claim, to enable cover to attach and to enable Riskpool to take such steps as it thinks fit in relation to the (anticipated) claim. That purpose is achieved once Riskpool has received notice of either a claim, or circumstances that may give rise to a claim, or a threat of a claim …
>
> A notification of a claim or intimated claim under condition 2(a) in a Fund Year after notification of a related occurrence, would result in inconsistent provisions in relation to allocation of the claim as between two Fund Years – the Fund Year of the first notification and the Fund Year of the second notification … the parties cannot have intended [this].

[110] The Council accepted however that if condition 2(a)(i) was engaged then it had a duty to notify Riskpool of the Lofts proceeding as soon as practicable. Mr Ring submitted this required the Council to notify Riskpool of the Lofts proceeding within five working days of the issuing of the Lofts proceeding on 14 September 2011. The Council's position was that, if it was obliged to notify Riskpool of the Lofts proceeding, then the time for notification had expired by the time the Board resolved to accept the commutation offer from Swiss Re on 3 October 2011.

[111] Thus, if the Council was required to notify Riskpool of the Lofts proceeding it needed to do so by the end of September 2011, at the very latest, in order for Riskpool to assess the statement of claim and take whatever steps it may decide in order to defend the proceeding within the timeframes prescribed by the High Court Rules.

---

[42] Plaintiff's closing submissions at [43] and [45].

[112] Condition 2(a)(i) of the Protection Wording required the Council to give Riskpool notice of "any claim". The natural and ordinary meaning of "any" in this context means "all claims" and "each and every claim" in addition to notice of an intimation of a claim or occurrence.[43] The Council's argument that cl 2(a)(i) did not impose upon the Council an obligation to notify Riskpool of the Lofts proceeding if receipt of that proceeding was preceded by the Council having given notice of an intimation of a claim, or occurrence under conditions 2(a)(ii) or 2(b) imposes an implausible meaning upon the words "any claim" and offends the basic tenet of contract interpretation that words of a contract should be given their "natural and ordinary meaning".[44] This principle has been explained by the Supreme Court as meaning "the plainer the words, the more improbable it is that the parties intended them to be understood in any sense other than what they plainly say".[45]

[113] There are two textual reasons why there is no attraction in the argument advanced by Mr Goddard that compliance with condition 2(a)(i) in addition to either conditions 2(a)(ii) or 2(b) "would result in inconsistent provisions in relation to [the] allocation of the claims as between two Fund Years".

[114] First, the preamble to the Protection Wording makes it clear that when a claim against a member is accepted the indemnification is in respect of a claim "first made against the member and reported to the fund during the period specified in the Schedule" to the Protection Wording. The reference to "claim first made" means that a claim is allocated to the fund year in which the claim is first made. Consistent with this approach the parties have proceeded on the basis that if the Council were to be indemnified in relation to the Lofts proceeding then any payment would, in the first instance, come from the 2004 fund.

[115] Second, conditions 2(a) and 2(b) of the Protection Wording deem any claim that follows notification of an intimation of a claim or an occurrence to have been made during the subsistence of membership. Mr Ring correctly submitted this

---

43 Desmond Derrington and Ronald Shaw Ashton *The Law of Liability Insurance: Volume 1* (3rd ed, LexisNexis, Butterworths, Australia, 2013) at [3-140].

44 *Investors Compensation Scheme v West Bromich Building Society* [1998] 1 WLR 896 (HL) at 913.

45 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [23].

deeming provision eliminates any possibility of a claim being allocated to more than one fund year.

[116] In addition to the textual analysis in [114] to [115] is the need to give effect to the parties' intentions, assessed objectively and in the context of the background facts in place when the Protection Wording was entered into.[46] The relevant facts include the need for Riskpool to decide if and how it might defend a claim against a member. Riskpool needed to make this assessment on a case by case basis in order to administer the fund in accordance with the governing documents. It could not do so simply on the basis of having been notified, years previously, of the possibility of a claim against a member. Riskpool could not meaningfully exercise its discretion to indemnify a member and defend a claim if the member failed to notify Riskpool of the commencement of a proceeding. Contrary to the effect of Mr Goddard's submission, Riskpool needed to assess a claim against a member by reference to the contents of the statement of claim. The mere fact that the member had notified the Council of an intimation of a claim, or an occurrence that might lead to a claim, was not sufficient for Riskpool to exercise its discretion to indemnify the member, or determine how it would defend the proceeding if it agreed to indemnify the member.

[117] My conclusion that the parties intended the Council would notify Riskpool of The Lofts claim even after the Council had previously given notice of an intimation of a claim or occurrence also reflects orthodox principles of insurance law. The authors of the *Law of Liability Insurance* explain:[47]

> In order to come within the description of the claim that is to be indemnified, or, in respect of an extension, of an occurrence that might give rise to a claim, the relevant occurrence invoked must be causative of the claim for which indemnity is later sought. This is a matter of fact and impression. There is an issue whether the insured must follow up the notice with further notice of the claim when it is received. *This is usually within the general terms of the policy's general conditions as to notice, but even if that is absent, such later notice is of such commercial importance to the insurer that there should be no implication that it should be excused by the notice of potential claim*.

---

46 *Lloyds TSB Foundation for Scotland v Lloyds Banking Group Plc* [2013] UKSC 3, [2013] 1 WLR 366.

47 Derrington and Ashton *The Law of Liability Insurance*, above n 43, at [8-326] (emphasis added and footnotes omitted).

[118] Condition 2(g) of the Protection Wording also required the Council to "immediately" give Riskpool "all such information and assistance" it "may require to enable it to investigate and defend any claim and/or … to determine liability". On 1 June 2004, JLT asked the Council to "keep [Riskpool] informed of any developments". On 4 June 2004, Riskpool reminded the Council of its obligation to keep Riskpool advised of "further developments". The plain and obvious meaning of condition 2(g) was that, having asked the Council to keep Riskpool advised of "further developments", the Council was required to notify Riskpool of the Lofts proceeding in September 2011.

[119] The Council therefore breached cl 2(a)(i) and 2(g) of the Protection Wording.

Scheme Rules

[120] As noted at [37], r 23.1 of the Scheme Rules required the Council to report "as soon as possible" to Riskpool, "any occurrence, circumstance, claim, *statement of claim*, summons or proceedings … or knowledge of any occurrence or circumstances which may subsequently give rise to a claim covered by the Scheme".[48]

[121] The reference to a requirement for a member to notify Riskpool of a statement of claim or proceedings signifies the importance the parties placed upon the commencement of proceedings against a member. The filing and serving of a statement of claim is a sentinel event in litigation. Riskpool needed to know of the Lofts proceeding to determine if it would indemnify the Council and if so, how it would best protect the interests of the Scheme and Council.

[122] Rule 23 is worded in a similar way and has a corresponding purpose to conditions 2(a) and 2(b) of the Protection Wording. For the reasons I have explained above, when interpreting conditions 2(a) and 2(b) of the Protection Wording, I am satisfied r 23.1 of the Scheme Rules also imposed a cumulative obligation on the Council to notify Riskpool of the Lofts proceeding when that proceeding was commenced in September 2011. Therefore, the Council also breached r 23.1 when it failed, as soon as possible, to notify Riskpool of the Lofts proceeding.

---

[48] Emphasis added.

[123] Rules 9.1.3 and 24 imposed essentially the same obligations on the Council as condition 2(g) of the Protection Wording. Thus, for the reasons I have explained in [118] I am satisfied the Council was also obliged under r 24 of the Scheme Rules to notify Riskpool of the Lofts proceeding in September 2011, and failed to do so.

Trust Deed

[124] Clause 16.2.3 of the Deed required the Council to "immediately advise the Scheme Manager of any underlying claim" and to "co-operate with the Scheme Manager and Scheme Solicitor in dealing with underlying claims".

[125] The requirement that a fund member immediately notify the Scheme Manager of any "underlying claim" reinforces my earlier conclusion that the Council was obliged to notify Riskpool of the Lofts proceeding before 1 October 2011. The Council breached this obligation.

Consequences of the Council's breach of its notification obligations

[126] Condition 2(a)(i) in the Protection Wording describes the notification obligation as a "condition precedent" to the member's "rights to be indemnified". Condition 5 also provides that the "due observation and fulfilment of the … conditions" in the Protection Wording "insofar as they relate to anything to be done or complied with by the member… shall be conditions precedent to any liability of the fund".

[127] In an insurance context, conditions precedent have been described as falling within one of two categories:[49]

> (1) a provision the breach of which was intended to entitle the insurer to treat the policy as a document which never became binding on her or him, or to treat a policy which ha[d] become binding on her or him as no longer binding; or
>
> (2) as a provision the breach of which entitled her or him to refuse to make a payment under it, either because the breach prevented any

---

[49] Ian Enright and Robert Merkin *Sutton on Insurance Law: Volume 1* (4th ed, Lawbook Co, Australia, 2015) vol 1 at [3.1090], citing *Kodak (Australasia) Pty Ltd v Retail Traders Mutual Indemnity Insurance Association* (1942) 42 SR (NSW) 231 (NSWSC).

> accrual of liability to pay or because it operate[s] to release the insurer from a liability which had in the first instance accrued.

[128] Riskpool accepts that use of the term "condition precedent" is not necessarily determinative of the consequences of a member's failure to comply with their obligations. Even if an obligation is classified in the governing documents as a "condition precedent" it is still necessary to objectively ascertain if the obligation is a genuine condition precedent. The character which should be attributed to any condition or term is a question of construction that depends on the language, terminology and context of the term.[50]

[129] For the Council, it was submitted that "Riskpool now appears to accept that [the condition precedent label in condition 2(a) of the Protection Wording] cannot be given the meaning it would generally have in a simple contractual context, as non-compliance with such a requirement does not exclude the Board's discretion under [the Deed], or permit or require the Board to decline a claim without considering other factors".[51] That submission, however, does not reflect the arguments advanced on behalf of Riskpool. Mr Ring said, that "compliance with a notice obligation is one of the most common types of condition precedent; and, viewed objectively, the parties' choice of these words in this context evinces a clear intention to imprint the notice obligations with orthodox condition precedent characteristics and consequences".[52]

[130] The most compelling argument in support of the Council's position, that its obligation to notify Riskpool was not a condition precedent to indemnification, is derived from r 27 of the Scheme Rules which, by virtue of r 3.1.3, takes precedence over the Protection Wording.

[131] As noted at [39], r 27 states that Riskpool will not provide indemnity where a member has breached a condition or obligation in the Protection Wording and where Riskpool is prejudiced by that "breach, failure … or omission". Mr Goddard submitted that any breach of its obligation to notify Riskpool of the Lofts proceeding

---

50 Enright and Merkin, above n 49, at [3.1110]; Robert Merkin and Chris Nicoll (eds) *Colinvaux's Law of Insurance* (Thomson Reuters, Wellington, 2014) at [5.1.1]; and *Newnham v Baker* [1989] 1 QD R 393 (QSC) at 401-402.

51 Plaintiff's closing submissions at [54].

52 Defendant's closing submissions at [4.36].

was of no effect unless Riskpool was prejudiced by the breach, failure or omission. From this proposition he said the notice obligation in the Protection Wording cannot be a condition precedent to indemnity as if this was the case there would be no need to assess any prejudice to Riskpool arising from the breach.

[132] There are, however, six reasons why I am satisfied that the Council's breach of its obligation under condition 2(a)(i) of the Protection Wording to give notice as soon as practicable to Riskpool of the Lofts proceeding was a condition precedent to indemnity.

[133] First, I am satisfied there is no conflict between condition 2(a)(i) of the Protection Wording and r 27 of the Scheme Rules and that accordingly, the condition precedent element of condition 2(a)(i) is not displaced by r 27 of the Scheme Rules. The reasons for this conclusion are:

(1) Rule 18 of the Scheme Rules states "… the Scheme will indemnify each Scheme Member against claims for damages or compensation in accordance with the Protection Wording …". Thus, the Protection Wording is an integral part of the terms of a member's entitlements under the Scheme.

(2) Rule 27 has to be read in the context of it being a general provision, whereas condition 2(a)(i) of the Protection Wording specifically defines a member's obligation to give notice of a claim as a condition precedent to indemnification. The principle of interpretation whereby specific provisions of a contract will be given greater weight than general provisions when the issue before the court falls within the scope of the specific provisions, is apposite in this case.[53]

[134] There was no irreconcilable conflict between condition 2(a)(i) and r 27. Condition 2(a)(i) provides specific consequences for the Council's failure to give notice of a proceeding as soon as practicable, whereas r 27 covers other circumstances,

---

[53] Sir Kim Lewison *The Interpretation of Contracts* (6th ed, Thomson Reuters, London, 2015) at [7.05]; and see generally *Cusack v London Borough of Harrow* [2013] UKSC 40, [2013] 1 WLR 2022.

where a breach by the Council of its obligations under the Scheme Rules or Protection Wording will not entitle Riskpool to decline to indemnify the Council unless Riskpool is prejudiced by the Council's "breach, failure or … omission".

[135] Second, the classification of condition 2(a)(i) as a condition precedent to indemnification is reinforced by conditions 2(g) and 5. The combined effect of those provisions imposed on the Council an additional notification obligation that had "condition precedent" status.

[136] Third, the text of condition 2(a) specifically states that compliance with the notice obligations in that condition is a "condition precedent to [the member's] rights to be indemnified". The Protection Wording thus makes express provision for the consequences of a breach of condition 2(a). As was stated in *London Guarantee Co v Fearnley*:[54]

> When the parties to a contract of insurance choose in express terms to declare that a certain condition of the policy shall be a condition precedent, that stipulation ought, in my opinion, to receive effect, unless it shall appear either to be so capricious and unreasonable that a court of law ought not to enforce it, or to be sua natura incapable of being a condition precedent.

[137] Fourth, and closely related to the third reason, is that "if a particular stipulation is *expressly* said to be a condition precedent and it is capable of being such, then a court will so construe it on the ground that the intention of the parties is clear, unless there is overwhelming evidence to the contrary".[55]

[138] Fifth, the practical importance to Riskpool of being notified of a proceeding underscores the conclusion that condition 2(a)(i) in the Protection Wording has been properly classified by the parties as a condition precedent to indemnity. The practical significance to an insurer of being notified of a proceeding is that notification enables the insurer to take whatever steps are necessary to investigate and defend the claim. A helpful formulation of the relevance of notice provisions from a practical perspective was outlined in *Newnham v Baker*:[56]

---

54 *London Guarantee Co v Fearnley* [1880] 5 App Cas 911 at 919 (PC) per Lord Watson.
55 Enright and Merkin, above n 49, at [3.110].
56 *Newnham*, above n 50, at 401.

> Such a provision for notice may have sufficient practical importance for an insurer that it should be regarded by the parties as a condition precedent to liability in respect of the claim … The reason is obvious. The occurrence which would otherwise give rise to the insurer's liability is usually known to the insured but not to the insurer, who will frequently need the opportunity to investigate it shortly after it has occurred in order to protect its own interests.

[139] Sixth, the commercial importance to Riskpool of being notified of a proceeding reinforces Riskpool's argument that the notice requirement in condition 2(a)(i) of the Protection Wording was properly characterised as a condition precedent to indemnity. Receiving notice of a proceeding enables the insurer to "more accurately fix its reserves for future exposure with a reasonable level of predictability and compute future premiums".[57] Notification of a proceeding is a fundamental requirement of insurance policies that goes to the very heart of the contract between an insurer and an insured.[58]

[140] In view of the practical and commercial importance to an insurer of being notified of a proceeding against an insured, it is not surprising there are a number of cases in which courts have considered that an insured's notification obligation is a condition precedent to indemnification.[59] It is noteworthy that no case has been brought to my attention, and my own research has failed to find any case in which it has been held that an insured's obligation to notify an insurer is not a condition precedent to indemnity where the policy specifies that it is.

[141] Although, for the reasons I explain in Part IV, Riskpool was not an insurer of the Council, the principles of insurance law I have referred to in [136] to [140] are apposite to this case. It was of vital importance to Riskpool that it be notified of all proceedings that members wished Riskpool to cover. Riskpool needed to decide if it would exercise its discretion to provide the Council with indemnity pursuant to cls 4.2, 6.1.2 and 8.2 of the Deed, r 27 of the Scheme Rules and condition 2(h) of the Protection Wording. It could not do so if it was unaware of the Lofts proceeding.

---

57 Derrington and Ashton, above n 43, at [8-236].

58 See also *Newnham,* above n 50, at 401.

59 *Hiddle v The National Fire & Marine Insurance Co of New Zealand* [1896] AC 372 (HL); *L'Union Fire, Accident & General Insurance Co Ltd v Klinker Knitting Mills Pty Ltd* (1938) 59 CLR 709 (HCA); and *Pilkington United Kingdom Ltd v CGU Insurance Plc* [2004] EWCA Civ 23, [2004] Lloyds Report IR 891 (CA).

[142] This analysis leads to the conclusion that the Council breached a condition precedent to indemnification when it failed to notify Riskpool of the Lofts proceeding in September 2011. The consequences of breaching a condition precedent have been squarely put by the learned authors in *Colinvaux's Law of Insurance in New Zealand*:[60]

> If the term broken is expressed, or can be construed, as a condition precedent to the liability of the insurer, then breach of that term prevents the assured from bringing a claim for a loss to which the condition relates.

[143] As signalled, this conclusion is, however, not determinative of the Council's claim against Riskpool. As this case involves the Council's obligation to give notice of the Lofts proceeding, consideration also needs to be given to what impact, if any, s 9 of the Insurance Law Reform Act has upon this conclusion. That exercise is undertaken in Part IV of this judgment.

PART IV

SECTION 9 INSURANCE LAW REFORM ACT 1977

Context

[144] The advice of Riskpool's legal advisors at the time the Board decided not to indemnify the Council was that s 9 of the Insurance Law Reform Act was engaged and Riskpool would be able to establish sufficient prejudice to justify declining the Council's claim for indemnification. In yet another irony in this case, Riskpool's lawyers no longer suggest that s 9 applies in this case. Without conceding the point, Mr Goddard also accepted there were challenges in arguing that s 9 of the Insurance Law Reform Act governed the Council's request for cover. I shall briefly explain why I agree with Riskpool's revised position that s 9 of the Insurance Law Reform Act did not apply to the Council's request for indemnity in this case.

---

[60] Merkin and Nicoll, above n 50, at [5.1.3].

Legislation

[145] Section 9(1) of the Insurance Law Reform Act was enacted to ameliorate the automatic disqualifying effect at common law of an insured's failure to give notice of a claim in breach of a condition precedent concerning the giving of notice of a claim.

[146] Section 9(1) of the Insurance Law Reform Act provides:

> **9 Time limits on claims under contracts of insurance**
>
> (1) A provision of a contract of insurance prescribing any manner in which or any limit of time within which notice of any claim by the insured under such contract must be given or prescribing any limit of time within which any suit or action by the insured must be brought shall—
>
> …
>
> (b) … bind the insured only if in the opinion of the … Court determining the claim the insurer has in the particular circumstances been so prejudiced by the failure of the insured to comply with such provision that it would be inequitable if such provision were not to bind the insured.
>
> …

[147] Section 9(1) of the Insurance Law Reform Act would only be engaged in the present case if there were a contract of insurance between Riskpool and the Council.

[148] There is no definition of "contract of insurance" in the Insurance Law Reform Act. There is, however, an instructive definition of that term in the Insurance (Prudential Supervision) Act 2010. This states that a contract of insurance is:[61]

> … a contract involving the transference of risk and under which a person (the insurer) agrees, in return for a premium, to pay to or for the account of another person (the policyholder) a sum of money or its equivalent, whether by way of indemnity or otherwise, on the happening of 1 or more uncertain events …

[149] The Insurance (Prudential Supervision) Act was not in force at the time the Council and Riskpool entered their agreement (or when the governing documents were written) and there was no statutory definition of contract of insurance in any other legislation.

---

[61] Insurance (Prudential Supervision) Act 2010, s 7.

[150] The definition of "contract of insurance" in the Insurance (Prudential Supervision) Act reflects the approach taken by persuasive authorities which state there is no contract of insurance where the rights of a member of a mutual body are qualified by terms which empower the mutual body to determine whether or not to indemnify the member in a particular case. The mutual body's decision is, in effect, discretionary.

Authorities

[151] The first of the leading authorities on this issue was *Prudential Insurance Co v Inland Revenue Commissioners*, in which Channell J said the first requirement of a contract of insurance is that:[62]

> … for some consideration, usually but not necessarily for periodical payments called premiums, [an insured] secure[s] … some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event.

[152] The analysis in *Prudential Insurance Co* was followed by Sir Robert Megarry V-C in *Medical Defence Union Ltd v Department of Trade*.[63] That case concerned the meaning of "contract of insurance" in the Insurance Companies Act 1974 (UK). At issue was whether doctors and dentists who belonged to the Medical Defence Union, a mutual society, had a contract of insurance with the society. Sir Robert Megarry explained that members of the society had:[64]

> … no right to require the [society] to conduct legal proceedings for [them], and no right to require the [society] to indemnify [them] against claims for damages. All [they had was] the right to have [their] request for the [society's] help [to be] … properly considered by the [society] … In practice it is rare for such a request to be refused. Yet although the prospects of such a request succeeding are great, all that the member has by way of right is that [their] request should be properly considered, and, of course, if it is granted, that the [society] should conduct the proceedings or indemnify [the member], or both.

A similar approach was taken by Templeman J in *Department of Trade and Industry v St Christopher Motorists' Assoc Ltd*.[65]

---

62 *Prudential Insurance Co v Inland Commissioners* [1904] 2 KB 658 at 663.
63 *Medical Defence Union Ltd v Department of Trade* [1980] 1 Ch 82.
64 At 90.
65 *Department of Trade and Industry v St Christopher Motorists' Assoc Ltd* [1974] 1 WLR 99 (Ch).

[153] These authorities were followed by the Court of Appeal in *Commissioner of Inland Revenue v Motor Corp Holdings Ltd*,[66] when considering the meaning of "contract of insurance" in the Goods and Services Tax Act 1985. The Court of Appeal said that for there to be a contract of insurance, the insured must have "a legal right to the benefit where the claim falls within the terms of the agreement, and the agreement must have some value".[67]

Analysis

[154] On the basis of these authorities it is clear there was not a contract of insurance between Riskpool and the Council because Riskpool would, upon receipt of a claim, have a discretion as to whether or not it would meet a member's request for indemnity.[68] In exercising its discretion the Board needed to act lawfully. I discuss that obligation in Part V. For present purposes it is sufficient to note that the governing documents did not create an agreement whereby Riskpool would indemnify a member in relation to a claim for which a member may have cover under the Scheme. Accordingly, there was no contract of insurance between Riskpool and the Council.

[155] As s 9 of the Insurance Law Reform Act is not applicable to the present case, it is not necessary to consider the extent of any prejudice Riskpool suffered caused by the Council's failure to notify it of the Lofts proceeding in September 2011. That exercise is undertaken in Part V of this judgment, which focuses upon the Council's argument that Riskpool did not exercise its discretion lawfully when it declined to provide any level of indemnity to the Council in relation to the Lofts proceeding.

[156] Had it been necessary for me to apply s 9 of the Insurance Law Reform Act, I would have held that Riskpool was so prejudiced by the Council's failure to comply with its notice obligations that it would have been inequitable not to bind the Council to that obligation. My reasons for reaching that conclusion, had it been necessary to do so, mirror the analysis in Part V concerning the prejudice suffered by Riskpool. In summary, Riskpool was materially prejudiced by the Council's delay in notifying it of

---

66 *Commissioner of Inland Revenue v Motor Corp Holdings Ltd* (2005) 22 NZTC 19,126 (CA).

67 At [48] per Hammond J with whom McGrath J agreed, citing *Department of Trade and Industry*, above n 65.

68 Deed of Trust, cls 4.2 and 8.2; Scheme Rules, r 27; and Protection Wording, condition 2(h).

the Lofts proceeding because it agreed to commute its reinsurance policies with Swiss Re in circumstances where it would either not have done so had it known of the Lofts proceeding or it would have attempted to negotiate a higher commutation payment to cover that proceeding.

PART V

RISKPOOL'S DECISION

Context

[157] An alternative approach, to that in Parts III and IV, is to treat the Council's failure to notify Riskpool of the Lofts proceeding before Riskpool agreed to commute its reinsurance policies as a factor that the Board could take into account in assessing the degree, if any, of prejudice it suffered as a result of the Council's omission. This is the Council's preferred approach.

[158] The essential elements of this aspect of the Council's case can be distilled to the following four points.

[159] First, Riskpool is required to exercise its discretion for the purpose for which it was conferred. In exercising its discretion Riskpool could not act arbitrarily, capriciously or irrationally. Riskpool was, accordingly, required to take into account matters that were relevant to the exercise of its discretion and not take into account matters that were irrelevant to the purposes for which its discretion was conferred.

[160] Second, Riskpool took into account three irrelevant considerations, namely the fact that the Council had ceased to be a member of Riskpool in 2008, that the Council had received more in benefits than it had paid in contributions to Riskpool and that in order to indemnify the Council, Riskpool may have to seek further contributions from members.

[161] Third, Riskpool needed to assess the extent of any prejudice that it suffered as a consequence of the Council's failure to notify it of the Lofts proceeding in September 2011 and whether that prejudice could reasonably be addressed by quantifying the

amount of that prejudice. The Council says Riskpool needed to consider not only whether to allow the claim in full or decline it, but also whether it should accept the claim subject to making a reasonable allowance for any prejudice.

[162] Fourth, if Riskpool had considered the extent of the prejudice it would have concluded that the prejudice could be quantified. The Council says that this analysis would have led to Riskpool realising that any prejudice it had suffered did not justify it declining the Council's claim in its entirety.

[163] In summary, the Council argues that by declining the Council's claim Riskpool acted contrary to the purposes for which its discretion was conferred and that its decision was arbitrary, capricious or irrational.

[164] The four factors I have examined at [159] to [162] will now be examined under the following headings:

(1) the legal requirements of Riskpool;

(2) irrelevant factors; and

(3) prejudice.

The legal requirements of Riskpool

[165] Clauses 2.4 and 6.2 of the Deed emphasise that the fund is held on trust for the benefit of members and that the Board will have regard to the purposes and objectives of the Deed and the Scheme when making decisions about the Scheme. At the same time, the Deed explains the discretionary nature of decisions by the Board to accept or decline an application for indemnity in relation to claims by a member. As noted at [31], cl 8.2 of the Deed refers to the Board having "absolute and unfettered discretion as to whether or not any claim should be met out of the pooled cover". The Board's discretion to indemnify is also referred to in cl 4.2 of the Deed, r 27 of the Scheme Rules and condition 2(h) of the Protection Wording.

[166] Notwithstanding the reference in cl 8.2 of the Deed to the Board having "absolute and unfettered discretion" to indemnify a member, there are limits upon the Board's discretion.

[167] In *Equitable Life Assurance Society v Hyman*, Lord Cooke explained "the principle that no legal discretion, however widely worded … can be exercised for purposes contrary to those of the instrument by which it is conferred".[69] His Lordship observed that this principle is "common to administrative law … and sundry fields of private law".[70] Similar observations were made by members of the Supreme Court of the United Kingdom in *Braganza v BP Shipping Ltd*,[71] in which it was explained that the exercise of a contractual discretion is subject to an implied term that the decision-making process will:[72]

> … exclude extraneous considerations, [and as] … part of a rational decision-making process … take into account those considerations which are obviously relevant to the decision in question … [and be] lawful and rational in the public law sense, [and] that the decision [will be] made rationally (as well as in good faith) and consistently with its contract purpose.

[168] The principles enunciated in these authorities lead to the conclusion that when a request from a member to cover a claim is received by Riskpool, the Board is required to exercise its discretion in a way that gives effect to the terms of the governing documents as well as the purpose of the Scheme. The purpose of the Scheme includes the mutual nature of Riskpool and the fact that it was established to assist local authorities manage their public liability risks. In order to exercise its discretion consistently with the terms of the governing documents and the purpose of the Scheme, the Board must not exercise its discretion arbitrarily, capriciously or irrationally.

[169] There is therefore an intertwining of the strands of public and private law governing the way the Board was required to exercise its discretion. Whilst there is a merger of public and private law principles concerning the duties of the decision-

---

69 *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408 (HL) at 460.

70 At 460, citing *Padfield v Minister of Agriculture, Fisheries and Food* [1968] AC 997; and *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

71 *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661 at [29]-[30], [52]-[53] and [102]-[103].

72 At [29]-[30] per Baroness Hale of Richmond.

maker in this case, that does not translate to a merger of public and private law remedies. Mr Ring erroneously suggested that an appropriate remedy, if one were to be granted, should mirror administrative law remedies and that I should remit the decision back to Riskpool for reconsideration if I found that Riskpool was liable to the Council. I disagree. If Riskpool breached its contractual or fiduciary obligations to the Council, then, in this case, damages would be the appropriate remedy.

[170] The principles enunciated in *Equitable Life Assurance Society* and *Braganza* are consistent with the discharge of any fiduciary duties owed by the Board to the Council. In the present case, the claim that Riskpool breached its fiduciary obligations to the Council when it declined to grant indemnity is, for all practical purposes, the same as the claim that Riskpool breached its contractual obligations to the Council not to act arbitrarily, capriciously and irrationally. No material differences were identified between the claims based on breach of contract and those that alleged Riskpool had breached its fiduciary duties to the Council.

Irrelevant considerations

[171] Consistent with its obligation to not exercise its discretion arbitrarily, capriciously or irrationally is the requirement that the Board's decision not have been based upon irrelevant considerations. In the present case, the Council seeks to impeach the Council's decision not to indemnify it in relation to the Lofts proceeding on the basis that the Board took into account three irrelevant considerations, namely that:

(1) the Council left Riskpool in 2008;

(2) the Council had received more in benefits than it had contributed to Riskpool; and

(3) indemnifying the Council might require a call for additional contributions from other members.

[172] I have already explained at [86] to [94] my conclusions that the concerns the Council had left Riskpool in 2008 and that the Council had received more in benefits

than it had contributed to Riskpool were minor considerations and did not influence the Board's decision in any meaningful way.

[173] For completeness, I record that had I concluded the Board had been influenced by concerns that the Council had left Riskpool in 2008 or that the Council had received more in benefits than it had contributed to the Scheme, then I would have decided these were irrelevant considerations and it would have been a misuse of the Board's discretionary power to have based its decision on these considerations. Treating the Council differently from other members of Riskpool, on the basis that the Council was no longer a member of Riskpool at the time it sought indemnification for a claim for a fund year in which the Council was a member of Riskpool, would have involved the Board discriminating against the Council and exercising its discretion for an improper purpose. Similarly, the Board would have misused its discretionary power if it had factored into its decision the extent to which the Council had made justified claims for indemnity in other fund years.

[174] It is apparent from Riskpool's letter of 2 December 2013 explaining the further ground for not indemnifying the Council that the Board was concerned that if the Council were to be indemnified, Riskpool might need to seek additional contributions to its 2004 fund from other Scheme members. Mr Sole also confirmed that the Board was concerned about the possibility of having to make additional calls on members if it agreed to indemnify the Council for the Lofts proceeding. This was criticised by Mr Goddard on the basis that it placed the Board in a conflict of interest.

[175] A conflict of interest may have arisen if the Board placed weight on a concern that making calls on other members would hasten the exodus of members, thereby undermining the financial strength of Riskpool as opposed to making a decision that focused fairly and squarely on the Council's claim. A decision of this nature would risk the Board breaching its fiduciary duty to the Council by placing the interests of Riskpool over those of an individual member.[73]

[176] In the present case however, the Board's concern about a possible additional call on members was limited to an apprehension that an additional call would produce

---

[73] *Braganza*, above n 71.

an inequitable outcome between members. In this respect, the Board's consideration was consistent with the outcome in *Equitable Life Assurance*,[74] in which the House of Lords held the Board of a Life Assurance Society was required to act fairly and justly as between members when calculating bonuses under a retirement with profits policy that contained a guaranteed annuity rate.[75]

[177] Riskpool's letter of 2 December 2013 to Heaney & Partners explains that the Board decided that it would be inequitable to other members of the Scheme to require them to make the contributions to cover the Lofts proceeding in circumstances where the need for such a call was caused by the Council's failure to comply with its notice obligations under the governing documents. By focusing on achieving an equitable outcome as between members, the Board did not place Riskpool into a conflict of interest or breach the fiduciary duties it owed to the Council.

[178] It is important to also emphasise that the Board's concerns about a possible additional call on members was an additional ground to the Board's primary reason for deciding not to indemnify the Council in relation to the Lofts proceeding. Riskpool's letters of 19 November 2013 and 2 December 2013 explain the basis of its decision and make it clear that the predominant reason the Board declined to indemnify the Council related to the Council's failure to notify it of the Lofts proceeding before Riskpool agreed to commute its reinsurance policies, thereby causing what the Board and its advisors believed to be material prejudice to Riskpool. In these circumstances I am quite satisfied that had the Board placed entirely to one side any concerns about a possible additional call on members it would have still decided not to indemnify the Council. Accordingly, the Board's concerns about a possible call for additional contributions from members was not a significant factor in its decision.

[179] For these reasons, I conclude that the Board did not take into account, in any material way, irrelevant considerations when it declined to indemnify the Council.

---

74 *Equitable Life Assurance Society*, above n 69.

75 See also Lord Woolf MR in the Court of Appeal judgment, *Equitable Life Assurance Society v Hyman* [2000] 2 WLR 798 (CA) at [16].

Prejudice

[180] The focal point of the Council's claim in this proceeding concerns the Board's assessment of prejudice it suffered as a result of the Council's failure to notify it of the Lofts proceeding in September 2011.

[181] For the purposes of my analysis of this aspect of the Council's claim, I proceed on the basis that prejudice to Riskpool was a factor the Board needed to take into account when deciding whether or not to accept the Council's application for cover in relation to the Lofts proceeding.

[182] The parties differed in their approaches as to what level of prejudice was required for the Board to lawfully exercise its discretion to refuse indemnity. From the Council's perspective, the Board was required to inquire into whether there was "material prejudice" in the sense of "prejudice that is sufficient to matter, in the context of the decision the Board was required to make".[76] Riskpool preferred a description of "more than *de minimis* prejudice".[77]

[183] The only clause in the governing documents that directly addresses prejudice is r 27 of the Scheme Rules, which states that without limiting its discretion, the Board may refuse indemnity where there has been a relevant breach and "the Scheme is prejudiced by that breach, failure, act or omission".[78] The absence of the word "material" in the governing documents provides a degree of support for Riskpool's submission.

[184] In my assessment, however, Riskpool has understated the required level of prejudice in this case. Requiring the Board to be satisfied that Riskpool was materially prejudiced by the Council's breach or omission is more consistent with the discretionary nature of the Board's decision-making power. The Board would not be honouring its obligations as the administrator of the Scheme, or the rights of members if it were to decline a claim for indemnity based on late notification of that claim in

---

76 Plaintiff's closing submissions at [72].
77 Defendant's opening submissions at [1.5(2)(a)].
78 Scheme Rules, r 27.2.

circumstances where Riskpool suffered less than material prejudice as a result of the member's breach or omission.

[185] The Board needed to inquire into, so far as was reasonably possible, the extent to which it had been genuinely prejudiced by the Council's failure to notify it of the Lofts proceeding in September 2011. In this respect, the Board was required to act in the same manner as any prudent, reasonable and objective decision-maker would act if placed in the same position as the Board.

[186] The real issues raised about the Board's consideration of prejudice can be addressed by focusing upon the following two questions:

(1) what steps did the Board need to take to discharge its legal obligations when considering any prejudice Riskpool may have suffered?

(2) did the Board act unreasonably in failing to conclude that any prejudice it may have suffered could be mitigated by accepting the Council's request for cover on a conditional or limited basis?

Counterfactual analysis

[187] The Council says the only way the Board could have exercised its discretion lawfully was by asking what it would have done if it had known of the Lofts proceeding at the time of the commutation. The Council argues that the Board should have analysed the nature and extent of any prejudice it believed it suffered by reference to counterfactual scenarios, and by assessing the quantity of any prejudice it suffered.

[188] Riskpool maintains the Board was not bound to undertake a complicated multi-counterfactual hindsight analysis.[79] As it transpires, in this case I am satisfied that it was not possible for the Board to have undertaken the level of counterfactual analysis contended by the Council.

---

[79] See for example, in *CVG Siderurgicia del Orinoco SA v London SS Owners' Mutual Insurance Assoc Ltd* [1979] 1 Lloyd's Rep 557 (QB).

[189] I am satisfied however, that in the context of this case, the Board was required to undertake an objective inquiry into whether it would have acted differently had it known of the Lofts proceeding at the time of the commutation. The Board was alert to this line of inquiry because the minutes of its meeting of 3 October 2013 record that it sought advice from Mr Carpenter on "what advice the directors would have received at the time of the commute" if Riskpool had known about the Lofts proceeding in October 2011.

[190] There were three broad counterfactuals that the Board could have considered, in November 2013, when it decided to decline cover to the Council for the Lofts proceeding. Had it known about the Lofts proceeding in October 2011, then:

(1) the Board could have continued with the commutation agreement with Swiss Re for $12m;

(2) the Board could have declined the commutation offer from Swiss Re for $12m; or

(3) the Board could have negotiated a higher offer from Swiss Re to take account of the Lofts proceeding.

[191] Counterfactuals (1) and (2) are the converse and obverse sides of the same scenario.

[192] It is clear that had Riskpool known about the Lofts proceeding at the time it considered the commutation offer it would not have accepted the $12m offer. Mr Sole, who was an advocate of commutation, said in evidence that he would have advised against accepting the $12m from Swiss Re had the Board known about the Lofts proceeding. Mr Heaney QC explained in his evidence the Board would have been "out of [their] minds" to have accepted commutation for $12m had it known of the Lofts proceeding.[80]

---

[80] Notes of Evidence at 23, lines 7-8.

[193] Mr Sole and Mr Heaney's evidence on this point is unimpeachable. The decision in October 2011 to commute for $12m was finely balanced. Having a new leaky building claim on Riskpool's books in which the plaintiff was seeking $9.2m would undoubtedly have caused any responsible member of the Board to vote against a $12m commutation offer. Even if the Board evaluated the Lofts proceeding solely on the basis of the reserve of $2m that Heaney & Partners had recommended to the Council in 2011, the Board would still have been highly unlikely to have proceeded to accept the $12m offer from Swiss Re knowing that the Lofts proceeding was on its books because, even if the $2m was an accurate reserve, it would have significantly eroded the $2.3m that Mr Sole had calculated was the "free board" in the Swiss Re offer.

[194] Thus, in relation to the first two counterfactuals the Board would have declined Swiss Re's offer of $12m in October 2011.

[195] In his advice to the Board, Mr Ring referred to the counterfactual of the Board declining the offer from Swiss Re. He said "clearly, the counterfactual position is that, if advised in late 2011 of the statement of claim, Riskpool would have maintained its access to these reinsurance funds". Consistent with the advice from Mr Ring and its other advisors, the Board therefore proceeded on the basis when making its decision in November 2013 that had it known of the Lofts proceeding in October 2011, it would have declined the $12m commutation offer.

[196] As a consequence, the Board concluded in November 2013 it had been materially prejudiced by agreeing to the commutation in October 2011 without knowing about the Lofts proceeding. The Board decided Riskpool had been so prejudiced by the Council's failure to notify it of the Lofts proceeding, that it was justified in rejecting the Council's claim for cover *in its entirety*. It is the decision of the Board to decline the Council's claim in its entirety that engages the third counterfactual.

[197] The Board had advice concerning, in broad terms, the scenario of a negotiated higher offer with Swiss Re. The advice from Morrison Kent stated that "had the Council notified Riskpool of the service of proceedings in or about September 2011

then this would have allowed the … Board to factor this into [its] negotiation with Swiss Re …". Mr Carpenter also referred the possibility of having raised "a sizable reserve that would have formed part of the commute offer analysis".

[198] The real issue is therefore the Board's failure to quantify the third counterfactual. The Council says that the Board should, in November 2013, have undertaken a far more nuanced assessment of the degree to which Riskpool had been prejudiced by the Council's failure to notify it of the Lofts proceeding in September 2011.

[199] This aspect of the Council's claim invites me to determine whether the Council is now entitled to an award of damages based upon an allowance "… for any additional amount that Swiss Re would have been likely to agree to pay to commute the reinsurance policies if the Lofts [proceeding] had been notified to Riskpool in September 2011".[81]

[200] The Council also submits that the Board, in November 2013, should have focused on "the reserve for [the Lofts proceeding] that was likely to have been set in 2011, had the claim been notified to Riskpool at that time".[82]

[201] The evidence varied widely on what reserve would have been placed on the Lofts proceeding in September 2011 by Riskpool if it had known about that proceeding before agreeing to the commutation offer from Swiss Re.

[202] The Council called as witnesses Mr Rhodes and Mr Coulter, both of whom are actuaries at PricewaterhouseCoopers. Mr Ring objected to their evidence on the basis that as actuaries, neither Mr Rhodes nor Mr Coulter were qualified to give expert evidence on what reserve a prudent insurance claims manager would have placed on the Lofts proceeding in September 2011.

---

81 Plaintiff's closing submissions at [13].

82 At [140].

[203] There is merit to Mr Ring's objection as demonstrated by the fact there was very little reference made to the evidence of Mr Rhodes and Mr Coulter in the closing submissions from either counsel.

[204] I have decided however, albeit by the narrowest of margins, that I have been sufficiently assisted by the evidence of Mr Rhodes and Mr Coulter that it should be admitted pursuant to s 25(1) of the Evidence Act 2006. Their evidence has assisted me to understand in greater depth the evidence of Mr Carpenter and Mr Heaney concerning the reserves that might have been placed on the Lofts proceeding.

[205] For completeness, I record that Messrs Rhodes and Coulter's evidence was that they would have advised the Board in September 2011 to have sought an additional $2.3m to $4m from Swiss Re on account of the Lofts proceeding if it had been brought to Riskpool's attention at that time.[83]

[206] Mr Carpenter said in his evidence-in-chief that he would have recommended a reserve of $6m for the Lofts proceeding if Riskpool had been notified of that proceeding in September 2011. He explained that his assessment of a $6m reserve was based in part on his suspicions about the ability of other defendants in the Lofts proceeding to pay any damages and his concerns about Mainzeal would have caused him to take a cautious approach to setting a reserve for the Lofts proceeding.[84]

[207] In cross-examination, Mr Carpenter accepted that $6m was at the upper end of the range of any reserve he would have put in place for the Lofts proceeding and he acknowledged that a realistic range for a reserve was between $4.8 and $6m.

[208] Mr Carpenter also acknowledged in cross-examination that he would not have harboured concerns about Mainzeal's solvency in 2011. When pressed further, Mr Carpenter said in cross-examination:[85]

> I don't know what I would've done at the time, I'm trying to step back and imagine what we would've done. Yes I accept whether it was six million, I don't know, I was trying to step back into time and say if this had hit me afresh with what I know and how I feel about these claims, the fact that councils are

---

83 Joint Brief of Evidence of PM Rhodes and BA Coulter, 26 June 2017 at [44].
84 Brief of Evidence of PA Carpenter, September 2017 at [100] and [101].
85 Notes of Evidence at 185, lines 29-34 and 186, lines 1-3.

> the last man standing with limitation periods expiring and all of those things what would I have done? I maybe wrong with the $6 million figure, I was never given the opportunity to do it in 2011. That's why it's very hard I think for us to sit here and with precision say what we would've done in 2011.

[209] The lowest reserve estimate for the Lofts proceeding came from Heaney & Partners who, on 25 November 2011, recommended the Council set a reserve of $2.25m which included a $0.25m allowance for costs. Mr Heaney said in his evidence however, that if Riskpool had known of the Lofts proceeding in September 2011 when considering the commutation offer from Swiss Re, then the reserve for the Lofts proceeding would have been much higher than $2.25m. Mr Heaney said that the existence of the commutation offer would have resulted in a higher reserve because "if [Riskpool had] a chance of getting money [off] the reinsure[er] why wouldn't you [take] the whole lot … frankly?"[86]

[210] It is, from the vantage point of 2017, understandable why there is a high degree of ambivalence in the minds of people such as Mr Carpenter and Mr Heaney when trying to retrospectively determine what reserve would have been placed on the Lofts proceeding, by Riskpool, in September 2011. It is, with the benefit of hindsight, very difficult to ignore how fallible any reserve set in September 2011 for the Lofts proceeding is likely to have been. Even a reserve of $6m would have been substantially lower than the approximate $8.5m sum that the Council paid to settle the Lofts proceeding.

[211] The Council's case was closed on the basis that if the Board had turned its mind to the issue it would have proceeded in 2013 on the basis that a reserve of $2.3m to $4m would have been put in place if Riskpool had known about the Lofts proceeding in September 2011.

[212] Mr Goddard submitted that on this basis, Riskpool "would have asked Swiss Re to 'refresh its offer' in light of the [reserve of $2.3 to $4m] … Swiss Re would have done so … [and] the Board would have accepted the [increased] offer".[87] Mr Goddard submitted:[88]

---

86 Notes of Evidence at 18, lines 5-8.
87 Plaintiff's closing submissions at [157].
88 At [158] and [159].

> it follows that the Board would have concluded that in this more likely counterfactual, any prejudice to Riskpool was in the range of $2.3 to $4m. If the Board adopted a conservative approach [in November 2013] it would have accepted the Council's claim, subject to an allowance of $4m to be deducted from the amount otherwise payable to the Council. If the Board adopted a more balanced approach it would have set an allowance of $3.15m.

[213] There are, however, a number of difficulties with the hypothesis advanced by Mr Goddard.

[214] First, as illustrated by the evidence of Mr Carpenter that I have referred to at [208] and the evidence of Mr Heaney referred to at [209], there are very real difficulties in retrospectively determining what reserve would have been put in place if Riskpool had been notified of the Lofts proceeding in September 2011, particularly in the context of the commutation offer from Swiss Re and issues about what, if anything, other defendants and third parties would have been able to contribute to a settlement.

[215] Even if, for present purposes, it is accepted that the reserve would have been in the vicinity of $2.3m to $4m, the Board could not have made an assessment in November 2013 about how Swiss Re was likely to react to the Lofts proceeding had it been brought to Riskpool and Swiss Re's attention in September 2011. The Board had no information before it to enable it to assess how Swiss Re would have responded to a request to increase its offer to reflect the Lofts proceeding. The Board could not retrospectively assess what reserve the claims assessors and actuaries at Swiss Re would have placed upon the Lofts proceeding and whether decision-makers at Swiss Re would have accepted those assessments, particularly in light of the wide range of views that the advisors to the Board now have about what an appropriate reserve for the Lofts proceeding would have been in 2011.

[216] This absence of information is further underscored by the fact that even at this juncture, there is no direct evidence about how Swiss Re was likely to have responded to the Lofts proceeding in September/October 2011. It would have been helpful if there had been some evidence on this issue from Swiss Re.

[217] As matters stand, I am asked to make a judgment about liability by gazing into an evidential lacuna. I cannot accede to the submission that Swiss Re would have

"refreshed its offer" to reflect a reserve of between $2.3m to $4m for the Lofts proceeding as that argument invites me to assume answers to unknown matters. While drawing inferences is a legitimate form of judicial reasoning, guesswork is not.

[218] In my assessment, the Board cannot be criticised for failing to quantify the prejudice it suffered. This conclusion is reinforced when considering the test that is to be applied when assessing the lawfulness of the way the Board exercised its discretion. The Board did not act arbitrarily, capriciously or irrationally when it assessed the prejudice Riskpool had suffered without quantifying that prejudice. The Board was entitled to conclude that material prejudice had resulted on the basis that it would have declined the commutation offer from Swiss Re for $12m had it known about the Lofts proceeding in October 2011.

Surplus of $2.3m

[219] In a separate tact from the counterfactual analysis I have considered at [187] to [218], Mr Goddard advanced the argument that "… damages of $2.3m should be awarded based on the profit that the Board knew Riskpool had (on the balance of probabilities) made from the commutation as at November 2013".[89]

[220] That submission is less speculative than the counterfactual analysis put forward by the Council because there is tangible evidence that on 3 October 2013 Riskpool, acting on actuarial advice from Melville Jessup Weaver, recognised in its statement of income the "[approximate] $2.3m surplus in the 2011 commutation".

[221] There is thus, a legitimate factual foundation for the submission that the commutation agreement produced a surplus of approximately $2.3m and that the Board "… could have agreed to pay up to $2.3m to the Council while remaining in surplus on a central estimate basis".[90]

[222] There are however difficulties with concluding on the state of the evidence before me that the Board should have agreed to indemnify the Council up to $2.3m

---

89 Plaintiff's closing submissions at [12].
90 Plaintiff's closing submissions at [120].

based upon Riskpool having "profited" by approximately $2.3m as a result of its commutation agreement. These difficulties relate to two concerns.

[223] First, the estimated "surplus" of $2.3m from the commutation agreement was an actuarial assessment made in mid-2013. I have not had the benefit of evidence on whether that estimate could, in November 2013, have been accurately treated as a genuine profit from the commutation agreement. Even now I have not had evidence on how any surplus from the commutation agreement should have been recorded in Riskpool's accounts.

[224] The second difficulty relates to the terms of the Deed of the Scheme Rules governing the sources of funds from which payments may be made to a member. As explained at [28] and [40] the sources of funds to pay a claim against a member are set out in an ascending order, starting with the pooled cover for the fund year to which the claim relates, followed by indemnity cover for that fund year, followed by surpluses from previous fund years, followed by additional contributions from members, followed by guarantees provided by LGIG.

[225] As I understand Mr Sole's evidence, the approximate $2.3m surplus from the commutation agreement was entered into Riskpool's income statement for the 2013 year and it did not form part of the pooled cover for the 2004 fund year. There was no evidence on whether the approximate $2.3m surplus should have been applied to the 2004 fund year, or, apportioned to the fund years to which the commutation related or, treated in some other way in Riskpool's accounts.

[226] It is difficult to see how the Board could have agreed to pay the approximate $2.3m surplus to the Council from the commutation agreement by way of a limited or qualified indemnity in relation to a claim that, if it were accepted, would have been paid from funds and/or indemnity for the 2004 fund year, and where there has been no evidence that any surplus from the commutation agreement should have been applied to the 2004 fund year.

[227] For these reasons, the evidence does not enable me to conclude that the Board acted arbitrarily, capriciously or unreasonably by not applying the $2.3m surplus from the commutation payment towards a limited or qualified indemnity of the Council.

Ex gratia payment

[228] Although not pleaded by the Council, Mr Sole alluded to the possibility of the Board making an offer of an ex gratia payment but said there was no "appetite" for the Board to follow that course of action.

[229] Trite though it may seem, I record for completeness that the Board could not be liable for failing to offer an ex gratia payment in circumstances where it lawfully declined to indemnify the Council in relation to the Lofts proceeding.

PART VI

CONCLUSIONS

[230] The Council was required to notify Riskpool before 1 October 2011 of the Lofts proceeding. Its failure to do so:

(1) constituted a breach of a condition precedent to being indemnified by Riskpool in relation to the Lofts proceeding; and/or

(2) caused material prejudice to Riskpool when it agreed to commute its reinsurance policies without being notified of the Lofts proceeding.

[231] Had Riskpool been aware of the Lofts proceeding before it agreed to commute its reinsurance policy it would not have proceeded with the commutation agreement for the sum it received. While it is possible Riskpool may have sought an increase in the commutation offer it received from Swiss Re, it was not possible for the Board, when making its decision to have reasonably assessed how Swiss Re would have responded to notice of the Lofts proceeding in September/October 2011. The Board could not determine if Swiss Re would have in fact increased its offer and if so, by how much.

[232] The Board could not, on the state of the evidence before me, reasonably have quantified the extent of any prejudice Riskpool suffered so as to warrant Riskpool offering a limited or qualified indemnity to the Council.

[233] Riskpool cannot be criticised for not applying the $2.3m, entered into Riskpool's income statement for 2013, towards a qualified or partial indemnification of the Council. That sum, which reflected the surplus from Riskpool's commutation agreement, could not, on the state of the evidence before me, have been applied to a claim which, if it had been accepted, would have been deemed to have arisen against the 2004 fund.

[234] In exercising its discretion not to indemnify the Council, Riskpool was required to exercise its discretion for the purpose for which it was conferred. In exercising its discretion, the Board did not take into account irrelevant factors. Nor did the Board act arbitrarily, capriciously or irrationally. On the contrary, the Board took advice from responsible professionals and reached a decision that was reasonably available. Its decision was not contrary to the evidence or legal principles which governed the Board's decision.

[235] The Board did not breach either its contractual or fiduciary obligations to Riskpool. The Council's claim is accordingly dismissed.

[236] Costs are reserved. If the parties are unable to reach agreement in relation to costs, then they should file memoranda with the court by 22 December 2017 explaining their respective positions.

D B Collins J

Solicitors:

Simpson Grierson, Wellington for Plaintiff
Hunter Young, Christchurch for Defendant