

THE DEEP
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Te Kōmata o
Te Tonga

The extent of EQC liability for damage from sea-level rise

Research Report for the
Deep South National Science Challenge

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Every effort has been made to ensure the soundness and accuracy of the opinions and information expressed in this report. While we consider statements in the report are correct, no liability is accepted for any incorrect statement or information.

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Executive summary

This paper considers the extent to which damage associated with sea-level rise is covered by insurance administered by the Earthquake Commission (EQC). EQC provides a natural disaster insurance scheme to help households recover from disaster and manage the fiscal risk to the Crown from natural hazards. While sea-level rise is not an insurable event, it will substantially increase damage from storms, flooding and landslips, which is covered by EQC.

EQC cover complements private residential building insurance by providing cover for land underneath insured buildings damaged by natural disasters, and is bundled together with private insurance, meaning that if private insurers withdraw cover due to increased risk, EQC cover is also withdrawn.

While EQC's role is in post-event recovery, it has a range of methods available for settling claims, including replacement, reinstatement, and relocation, and is able to require that claim settlement payments be used to repair damage, meaning it also has an indirect role in pre-event resilience. Further, EQC's recently adopted approach to settling claims for increased flooding vulnerability by paying the diminution of land value arguably extends its role beyond its primary focus of immediate recovery from disaster.

However, EQC does not currently have discretion to take pre-event resilience into account when electing claim settlement methods.

An inquiry into the EQC scheme is currently underway, focused on the Canterbury earthquakes, and as such the scope does not encompass climate change issues. The inquiry will inform legislative changes. While it is imperative that the inherent nature of EQC as a natural disaster insurance scheme is preserved, it is also clear that there is room to investigate changes to EQC's policies to enable it to take a direct role in supporting pre-event resilience, within its existing scope. This could be undertaken alongside the current inquiry.

EQC considers there is a time-bound dimension to managing the impacts of climate change, with the most significant effects likely to occur in the short term while longer-term planning is undertaken by local and central government. This does not preclude policy change in the short term; and reconsideration of EQC policies on relocation, replacement, and reinstatement, in particular, could also support longer-term planning by other agencies.

Introduction

Purpose and context

This paper considers the extent to which damage from storm surges, flooding and landslips associated with sea-level rise is covered by insurance against natural disaster provided under the Earthquake Commission Act 1993 (the Act) administered by the Earthquake Commission (EQC).

The paper is part of a project examining where sea-level rise risks currently fall across different parties (homeowners, government and private insurers), commissioned by the Deep South National Science Challenge Impacts and Implications research programme. The project focuses on residential coastal housing and aims to examine the current legal and policy framework and identify liability in respect to sea-level rise impacts, and any gaps in the framework.

Insurability in a changing climate

New Zealand is already the third most-vulnerable country in the world to natural disaster as a percentage of GDP.¹ Sea-level rise due to climate change will increase this vulnerability, particularly with regard to New Zealand's coastal housing stock. Even a small amount of sea-level rise will substantially increase damage from flooding and storm surges.² Some areas have already become uninhabitable, with coastal residents forced to relocate, either due to sudden-onset natural disasters or a series of smaller events that add up to large losses.³

The New Zealand government considers it important to help residential property owners avoid “socially unacceptable distress and loss in the event of a natural disaster”⁴ and provides a natural disaster insurance regime, which is administered by EQC. New Zealand has one of the highest

¹ Earthquake Commission *Briefing to the Incoming Minister Responsible for the Earthquake Commission* (October 2017) at 15.

² Parliamentary Commissioner for the Environment *Preparing New Zealand for rising seas: Certainty and Uncertainty* (November 2015) at 9.

³ Hamed R. Moftakari, Amir Aghakouchak, Brett F. Sanders and Richard A. Matthew “Cumulative hazard: the case of nuisance flooding” (2017) *Nature* 5, 214.

⁴ Earthquake Commission *Statement of Intent 2013-2016* (30 June 2013).

take-up rates of residential natural disaster insurance in the world,⁵ and over 90% of residential homeowners have cover with EQC.⁶

EQC helps minimise the unfunded fiscal risk to the Crown from natural hazards, providing a mechanism to manage state response to natural disasters.⁷ International experience suggests that, without an EQC-type scheme, most homeowners do not insure against natural hazards; this increases the fiscal risk for government if it is induced to provide compensation after a natural disaster.⁸

Further, in almost all cases where homeowners are exposed to a significant risk of sudden-onset natural hazards, the private insurance sector elects not to insure against those hazards.⁹ EQC cover complements that provided by private insurers (who do not offer the land cover provided by EQC)¹⁰ with the result that residential property owners in New Zealand are more comprehensively insured against natural disasters than homeowners overseas.

EQC policies are embedded within residential insurance policies.¹¹ Consequently, if private insurers withdraw from particular locations due to increased and/or unacceptable risk, EQC cover is also withdrawn. Withdrawal of insurance in situations of unacceptable risk to property serves as a signal to homeowners of that risk. As banks will generally not lend on uninsured property, insurance retreat can result in enforced relocation and reduction in property values.

As climate change drives sea-level rise and storm surges and flooding increase, the goal posts for insurable events are shifting. Higher tides and heavier rainfall mean that significant weather events are occurring more frequently. This means that events which would have been insurable

⁵ Cuong Nguyen and Ilan Noy *Insuring earthquakes: How would the Californian and Japanese insurance programs have fared down under (after the 2011 New Zealand earthquake)?* (Victoria University, SEF Working Paper 14, June 2017) at 4.

⁶ New Zealand Treasury *Treasury Report (T2015/1294): Home Insurance – Implications of Sum Insured Cover* (Reference 20160145 23, June 2015, Obtained under Official Information Act 1982 Request) at 9.

⁷ Belinda Storey and others *Insurance, Housing and Climate Adaptation: Current Knowledge and Future Research* (Motu Economic and Public Policy Research, Motu Note #17, Wellington 2017).

⁸ Above n 7. See also New Zealand Treasury *New Zealand's Future Natural Disaster Insurance Scheme: Proposed Changes to the EQC Act 1993* (ISBN 978-0-478-43681-5, 2015).

⁹ The many reasons why this is the case are discussed in I Noy, A Kusuma, and C Nguyen *Insuring disasters: A survey of the economics of insurance programs for earthquakes and droughts* (Victoria University, SEF Working Paper 11, 2017).

¹⁰ Although they do offer cover for retaining walls, bridges and culverts. See Earthquake Commission Act 1993, s 2 definition of “residential land”.

¹¹ Above n 7.

in the past could start to be considered as part of “normal” weather patterns rather than natural disasters, or that their occurrence is now so frequent they are no longer insurable events.

In some areas of New Zealand, such as Haumoana and Matatā, private insurance for coastal flooding has been withdrawn because of the particular vulnerability of these areas; flooding has already occurred, and there is a clear likelihood of future flooding.¹² The future for private flood insurance in such risky areas is unclear, with differing views. Interestingly, even without the predicted increase in flooding, insurance cover for flood already loses money in the long run.¹³ The reasons for providing flood cover are not economically rational, but about maintaining a modern brand of insurance, wherein all risks can and should be covered for a price.¹⁴ As a result, Duncan Webb suggests that withdrawal from the provision of flood insurance may take some time, as no insurer will want to be the first to offer unattractive policy terms, lose customers to its competitors and suffer negative publicity.¹⁵ Instead, Webb suggests that withdrawal is more likely to occur gradually through policy exclusions.¹⁶ This has happened overseas.¹⁷ Webb also asserts that it will not be the large storms that tempt private insurers to eventually withdraw from the market, but the cumulative costs of more frequent events. This is because reinsurance is readily available for offsetting the costs of extreme events, but not for offsetting cumulative losses.¹⁸ In contrast, Belinda Storey and others suggest that, because of the international nature of the insurance industry, significant weather-related losses elsewhere in the world could trigger local withdrawal.¹⁹

While insurance risk is constantly being reassessed and insurance retreat is happening around New Zealand, adaptation to climate change in coastal residential areas is not happening at the

¹² See the case study on Matatā in Catherine Iorns, *Case Studies on Insurance and Compensation after Natural Disasters* (Draft Working Paper for the Deep South National Science Challenge, September 2018) at 13-15.

¹³ Duncan Webb “Playing Dice with God: Insurance in a Climate of Change” (2008) 19 *ILJ* 2 at 9.

¹⁴ At 8.

¹⁵ At 10.

¹⁶ At 30-31.

¹⁷ Iorns, above n 12, at 9-12.

¹⁸ Above n 13, at 30.

¹⁹ Belinda Storey and others *Insurance, Housing and Climate Adaptation: Current Knowledge and Future Research* (Motu Economic and Public Policy Research, Motu Note #27, 2017) at 7.

same pace, leaving property owners exposed. The role and nature of EQC is increasingly being examined and proposals for extending or altering the scheme presented for debate.²⁰

This paper sets out the fundamental framework of EQC, outlines the role of EQC in relation to damage caused by storm surges, floods and landslides attributable to sea-level rise, and identifies potential gaps in the framework created in relation to future sea level rise.

²⁰ For example, “amend the legislative mandate of EQC so that it becomes responsible for both pre-disaster funding (i.e. for protective and preventative measures) and post-disaster funding;” Jonathan Boston and Judy Lawrence “Funding Climate Change Adaptation: the case for a new policy framework” *Policy Quarterly*, 14:2 (May 2018) at 46 – ultimately not recommended because it would undermine the scheme.

How EQC works

Background to the current scheme

The New Zealand government has had a natural disaster insurance regime in place since 1944, when the War Damage Act 1941 became the Earthquake and War Damage Act 1944 (partly as a result of major earthquakes in Napier in 1931 and Wellington in 1942).²¹

The legislative framework initially mirrored the British scheme²² but after the Second World War the New Zealand scheme was extended to cover storms and floods “of abnormal and unforeseen nature and of extraordinary and widespread effect”²³ and establish the Natural Disaster Fund, which financed the government’s expanding liabilities. In 1956, the scope was further expanded to include landslips and volcanic eruption.²⁴ This expansive provision of uncapped cover has been described as being “embedded in egalitarianism and the notion that collective, public approaches to planning and preparing for catastrophic disasters are better than private responses”.²⁵

In 1979, the largest-ever landslip in an urban area of New Zealand caused the destruction or relocation of about 70 houses and the evacuation of more than 600 people in Abbotsford, a suburb of Dunedin.²⁶ A Royal Commission of Inquiry into the disaster included a review of natural disaster insurance in its terms of reference.²⁷ This led to significant extended debate within government over the purposes and nature of the EQC scheme, and the introduction of land cover to the scheme.

In 1993, substantial changes were introduced in the form of the current Act, which is discussed further in the following sections. A current review of the Act is discussed toward the end of this paper.

²¹ Treasury, above n 8, at 15.

²² Mateusz Bek and others *Future Availability of Flood Insurance in the UK: A report on legal aspects of the solutions adopted in Australia, Iceland, the Netherlands, New Zealand and Turkey, with conclusions* (University of South Hampton, 2013) at 45.

²³ Finance Act (No 2) 1948, s 4.

²⁴ Earthquake and War Damage Regulations 1956, s 15(1).

²⁵ Iain Hay “Earthquake Insurance Reform in New Zealand” in Graham A Tobin and Burrell E Montz (eds) *Evolving Approaches to Understanding Natural Hazards* (Cambridge Scholars Publishing, Newcastle-upon-Tyne, 2015) 318 at 318.

²⁶ Canterbury City Libraries “Abbotsford Landslide” <www.Canterburycitylibraries.com>

²⁷ R.G. Gallen *Report of the Commission of Inquiry into the Abbotsford Landslip Disaster* (November 1980).

Earthquake Commission Act 1993

The Act provides for the constitution of the Earthquake Commission (the Commission) and insurance of residential property against natural disaster (the EQC scheme).

The Act does not have a clear statement of purpose.²⁸ The long title of the Act is to “...make provision with respect to the insurance of residential property against damage caused by certain natural disasters”.²⁹ During the first reading of the Bill that became the Act, it was noted that:³⁰

[T]he Government’s prime concern in the aftermath of a major disaster is a humanitarian concern. Thus, the priority should be the provision of basic, adequate housing and other amenities, and the reestablishment of a basic infrastructure, rather than meeting extensive obligations to those homeowners who are better off, and to business.

This essentially describes the inalienable purpose of EQC: to help households recover from disaster.³¹

The Act identifies two types of hazard - geological (earthquakes, geothermal activity, volcanic eruption) and atmospheric (resulting from extreme weather such as storms) - and provides cover for damage from the following natural disasters:³²

- earthquake, natural landslip, volcanic eruption, hydrothermal activity, or tsunami;
- natural disaster fire;
- storm or flood.

This paper considers storms, floods, and landslips, as these are predicted to increase in frequency and intensity on account of sea-level rise due to climate change.³³ Damage to residential land from storms is most commonly from landslip.³⁴

The Act provides for cover for residential land in respect of storms and floods, and residential land and buildings in respect of landslips. Cover for land is for the value of the land;³⁵ the definition of residential land includes certain access ways, retaining walls, bridges and culverts,

²⁸ Treasury, above n 8, at 19.

²⁹ Earthquake Commission Act.

³⁰ (15 December 1992) 532 NZPD 13188.

³¹ Letter from Dr Hugh Cowen (Director Resilience Research, Earthquake Commission) to Catherine Iorns regarding comments on Catherine Iorns’ Sea-level rise draft report (26 February 2019).

³² Earthquake Commission Act, s 2 definition of “natural disaster”.

³³ Storey, above n 7.

³⁴ Above n 31.

³⁵ See Earthquake Commission Act, s 19. The amount recoverable is capped at whichever is smallest of the amounts listed at s 19(a)(i)-(iii).

which are covered to indemnity value.³⁶ Cover for buildings is at replacement value but capped at \$100,000³⁷ (though that cap is soon to increase to \$150,000).³⁸

Earthquake Commission

The Act provides that the Crown entity called the Earthquake Commission, previously the Earthquake and War Damage Commission, shall continue to exist. The Commission is a Crown agent under the Crown Entities Act 2004. Crown agents have less autonomy than other types of Crown entities and must give effect to government policy when directed by the responsible Minister. However, the Commission is specifically exempted from certain provisions of the Crown Entities Act relating to limitations on acquisitions of financial products, borrowing, guarantee and derivative rules, and is exempt from paying any net surplus to the Crown.³⁹

The functions of the Commission include:⁴⁰

- administering the insurance provided under the Act
- administering the Natural Disaster Fund
- obtaining reinsurance
- facilitating research and education about natural disaster damage, methods of reducing or preventing natural disaster damage and the insurance provided by EQC.

Natural Disaster Fund and Crown guarantee

The Act provides for the continuation of the Natural Disaster Fund (the Fund). (It is the same fund that was previously known as the Earthquake and War Damage Fund).⁴¹ Insurance premiums and any other money payable to the Commission are paid into the Fund⁴² and claims are paid out of it.⁴³

If the assets of the Commission, including the Fund, are not sufficient to meet claims, the Act provides that the Minister of Finance must meet the deficiency with a grant or advance from

³⁶ Earthquake Commission Act, s 19(b). See also s 2 definition of “residential land”.

³⁷ Section 18.

³⁸ Earthquake Commission “EQC Act changes announced” <www.eqc.govt.nz>.

³⁹ Earthquake Commission Act, Schedule 1.

⁴⁰ Section 5.

⁴¹ Section 13.

⁴² Section 14.

⁴³ Section 15.

public funds.⁴⁴ This Crown guarantee was triggered by the Kaikoura earthquake in 2016, after the Fund had been depleted by claims relating to damage from the Canterbury earthquakes.⁴⁵

Formation of cover and setting of premiums

EQC cover is provided and premiums collected by bundling disaster insurance with private contracts for fire insurance.⁴⁶ Cover is formed when a person enters into a contract for fire insurance for a residential building with a private insurer.⁴⁷ The Act provides that, while that contract is in force, the building will be insured against natural disaster damage with EQC⁴⁸ and the residential land on which the building is situated will similarly be covered.⁴⁹

Private insurers are obliged to pay the required premiums to EQC.⁵⁰ However, they are paid to EQC in bulk, without identification of individual contracts of insurance, nor even the addresses that are insured. As a result of this, EQC is unaware of who they insure until a claim is made.⁵¹

Premiums are set under regulations in accordance with Schedule 2 of the Act. The current premium is a flat rate of \$0.20 per \$100 of property insured.⁵² Prior to recent rises, the premium had remained unchanged for over 65 years, at \$0.05 per \$100 of property insured.⁵³ The EQC premium is set in proportion to the total cover provided under the Act; this figure is commonly \$100,000,⁵⁴ but can be less if the policy specifies a sum insured below \$100,000, or if replacement value is less than the cap.⁵⁵

Applying a flat rate nationwide means that the risk faced in more hazardous locations is spread across all policy holders, making natural disaster insurance affordable for those most exposed, and supporting high insurance penetration. However, it is noted that the flat rate also mutes the price signal which may otherwise flag an increased level of risk to residential property owners

⁴⁴ Section 16.

⁴⁵ Kurt Bayer “Briefings: Disaster fund ‘fully exhausted’ after Canterbury, Kaikoura claims” NZ Herald (7 December 2017) <www.nzherald.co.nz> See also Earthquake Commission *Briefing* (2017), above n 1.

⁴⁶ Earthquake Commission Act, s 14.

⁴⁷ Sections 18–19.

⁴⁸ Section 18.

⁴⁹ Section 19.

⁵⁰ Section 24.

⁵¹ Dr Hugh Cowen, above n 31.

⁵² Earthquake Commission Regulations 1993, reg 3.

⁵³ Treasury, above n 8, at 40.

⁵⁴ As at the date of writing this paper; the cap is to change, see Earthquake Commission Amendment Act 2019, s 8(1).

⁵⁵ Robert Merkin, Chris Nicoll and Raoul Colinvaux *Colinvaux’s Law of Insurance in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2017) at 15.4.9.

and other affected parties (such as local authorities responsible for maintaining infrastructure).⁵⁶

Direct cover

Direct EQC cover is available for residential buildings and land not covered through fire insurance, by application to EQC.⁵⁷ Uptake of direct insurance has been low,⁵⁸ possibly because of the already high penetration of EQC cover.

EQC recently reviewed its direct cover policy, and now has an underwriter to manage requests.⁵⁹ The Treasury has noted that direct cover serves as a safeguard for homeowners unable to secure private fire insurance, with the discretionary nature of the cover allowing EQC to exclude inappropriate risks.⁶⁰

Direct cover may become an important consideration for EQC in the context of retreat by private insurers. This is discussed further in the final chapter of this paper.

Timeframe for claims

The statutory time limit for lodging a claim with EQC is within three months after the damage occurs, or up to two years unless the lateness of the claim materially prejudices EQC's ability to assess the claim.⁶¹

⁵⁶ Storey, above n 7.

⁵⁷ Earthquake Commission Act, s 22.

⁵⁸ Earthquake Commission, above n 1, at 20.

⁵⁹ Above n 1, at 20. Dr Hugh Cowen, above n 31.

⁶⁰ Treasury, above n 8, at 35-36.

⁶¹ Note changes in the Earthquake Commission Amendment Act 2019, s 7.

Relationship between EQC and policy holders

The Act has a legislative structure resembling an insurance policy, with the policy being contained in section 2, part 2 and Schedule 3 of the Act.⁶² Courts have consistently held that the principles of insurance law ought to apply where not inconsistent with the statute.⁶³

However, despite the relationship between policy holders and EQC only coming into existence when a contract is formed, the relationship is not contractual.⁶⁴ For this reason, many ordinary insurance law protections are excluded from application.⁶⁵ Further, protections afforded under the general law of contract, such as the *contra proferentem* rule (which provides an ambiguous contract should be interpreted against the interests of the party that requested it), have been found not to apply to the provision of entitlements under the scheme.⁶⁶

Relationship between EQC and private insurers

The relationship between EQC and private insurers is complex and is critical to the success of the EQC scheme. As mentioned above, EQC cover complements that offered by private insurers, and fills a gap in that private insurers do not offer residential land cover. The fact that EQC offers something different from the private market is important; the Crown underwriting risk the private sector would bear could lead to higher premiums or cross-subsidisation by taxpayers.⁶⁷

EQC and private insurers work closely together in a variety of ways when settling claims. For example, in 2016, following the Kaikoura earthquake, EQC signed a memorandum of understanding with a number of private insurers, and those insurers are assessing and settling EQC home and contents claims for their customers, including claims under the EQC cap.⁶⁸

⁶² Paul Michalik and Christopher Boys *Insurance Claims in New Zealand* (LexisNexis, Wellington 2015) at 19.1.

⁶³ See *AMP Fire and General Insurance Co (NZ) Ltd v Earthquake and War Damage Commission* (1983) 2 ANZ Ins Cases 60-529 (CA), cited with approval in *Earthquake Commission v Insurance Council of New Zealand Inc* [2014] NZHC 3138, [2015] 2 NZLR 381 at [171]. See also *Kraal v Earthquake Commission* [2015] NZCA 13, [2015] 2 NZLR 589 at [63].

⁶⁴ *Coughlan v Earthquake Commission* [2007] NZHC 1787, NZAR 533 at [33]. Under the Act the claimant is described as “deemed to be insured”. See *Earthquake Commission Act*, ss 18, 19 and 20.

⁶⁵ Most significantly the Insurance Law Reform Act 1977. The jurisdiction of the Disputes Tribunal is also excluded on account of the relationship being non-contractual. See *Earthquake Commission v Disputes Tribunal* [1997] NZAR 115.

⁶⁶ *Earthquake Commission v Winch* HC Auckland (2008) 9 CPR 827 (HC) at [15]-[16].

⁶⁷ Dr Hugh Cowen, above n 31.

⁶⁸ Earthquake Commission “How we are settling Kaikoura claims” (5 April 2019) <www.eqc.govt.nz>

The authors understand that Insurance Council of New Zealand⁶⁹ is currently working on a protocol with EQC regarding lifting the floorboards of flooded houses to dry them out and prevent subsequent damage, such as from mould and rot; as EQC does not insure buildings for flood damage, it does not have an incentive to either undertake or enable this.⁷⁰

While the default position under the Act is that the private insurer provides the first layer of cover for buildings and EQC makes up any remaining loss once the fire policy is exhausted,⁷¹ this default may be inverted by the terms of the contract so that EQC covers the first layer of cover up to the statutory cap.⁷² Inversion has become the normal practice.⁷³ Some insurers have gone further by making their liability contingent upon all compensation from EQC having been paid first;⁷⁴ private insurers are more inclined to offer insurance if EQC bears the first risk.⁷⁵ This also enables EQC to respond promptly to claims.

Disputes with EQC

EQC provides an internal mediation service.⁷⁶ Claimants may take a complaint to the Ombudsman, seek advocacy from their electorate MP, or pursue formal litigation. Disputes by claimants with EQC cannot be brought before the Disputes Tribunal due to the non-contractual nature of the scheme,⁷⁷ and EQC is not subject to the oversight of the Insurance Ombudsman.⁷⁸ Claims against EQC can be pursued through the District Court up to the jurisdictional cap of \$350,000. EQC had previously considered that decisions should only be contested through judicial review in the High Court on the grounds that such decisions were discretionary exercises of powers conferred by statute.⁷⁹ However, in *Earthquake Commission v Insurance Council of*

⁶⁹ The Insurance Council of New Zealand (ICNZ) is a representative body established in 1895 to represent fire and general insurance companies. See Insurance Council of New Zealand “Our Work” <www.icnz.org.nz> .

⁷⁰ Tim Grafton, Chief Executive of the Insurance Council of New Zealand, in the National Business Review *Property owners should brace themselves for higher-risk profile* (30 May 2019).

⁷¹ Section 30(1).

⁷² Section 30(2).

⁷³ Merkin, above n 55, at 15.4.4. *Kraal v Earthquake Commission*, above n 63.

⁷⁴ Merkin, at 15.4.4. See also *Jarden v Lumley General Insurance* [2015] NZHC 1427. In this case a settlement between the customer and EQC was not made available to an insurer, therein leading the insurer to assert that no cover was payable in the absence of that information. Some insurers sell “fire only” policies, which creates a product for which EQC bears virtually all risk under the product that is sold. See also, Treasury, above n 8, at 40.

⁷⁵ Dr Hugh Cowen, above n 31.

⁷⁶ Above n 62, at 19.5.

⁷⁷ *Earthquake Commission v Disputes Tribunal*, above n 65.

⁷⁸ Above n 62, at 19.5.

⁷⁹ at 19.5.

*New Zealand*⁸⁰ the Court ruled that decisions about entitlements were fixed rather than discretionary, disputes were largely factual and usually required extensive expert evidence, and judicial review was too costly for most applicants.⁸¹ This led to the conclusion that judicial review was unsuited to resolving disputes over coverage, and access to justice would be infringed by limiting appeals to such an expensive process. It was deemed that Parliament must have intended for these disputes to be resolvable through the District Court.

⁸⁰ *Earthquake Commission v Insurance Council of New Zealand Inc*, above n 63.

⁸¹ At [171] and [197].

Damage and loss covered by EQC

Natural disaster damage

Natural disaster damage is defined as:

- (a) any physical loss or damage to the property occurring as the direct result of a natural disaster; or
- (b) any physical loss or damage to the property occurring (whether accidentally or not) as a direct result of measures taken under proper authority to avoid the spreading of, or otherwise to mitigate the consequences of, any natural disaster, but does not include any physical loss or damage to the property for which compensation is payable under any other enactment.

Rather than considering the magnitude of events, EQC assesses the extent of physical loss or damage when determining if natural disaster damage will be covered.⁸² This reflects the standard approach by private insurers to pay out on damage, not events. Any claim for damage caused by, for example, a storm would “involve a factual assessment by EQC as to whether the weather conditions constituted a storm”.⁸³

The only type of natural disaster defined in the Act is natural landslip,⁸⁴ presumably to distinguish it from erosion and other natural processes that do not generally constitute a disaster.

Storm and landslip events often occur concurrently, and flood events often include the dispersal of landslip debris.⁸⁵ In one sense, providing coverage for floods, storms and landslips means the Act covers all land damage likely to result from the same weather event.⁸⁶ However, it has been

⁸² Dr Hugh Cowen, above n 31.

⁸³ Above n 31.

⁸⁴ See Earthquake Commission Act, s 2 where natural landslip is defined: “**natural landslip** means the movement (whether by way of falling, sliding, or flowing, or by a combination thereof) of ground-forming materials composed of natural rock, soil, artificial fill, or a combination of such materials, which, before movement, formed an integral part of the ground; but does not include the movement of ground due to below-ground subsidence, soil expansion, soil shrinkage, soil compaction, or erosion.”

⁸⁵ See Tonkin & Taylor *New Zealand’s Future Natural Disaster Insurance Scheme Proposed changes to the Earthquake Commission Act 1993* (11 September 2015, Obtained under Official Information Act 1982 Request).

⁸⁶ As Tonkin and Taylor noted, flood events often include the dispersal of landslip debris. They further asserted that the current restriction of cover to residential land causes problems because flood and landslip debris are often mixed yet require distinction under the Act because of the divergence in what is covered between the “two” events. See above n 85, at 14-15.

suggested that the distinction between cover for land and buildings “causes problems because flood and landslip debris are often mixed yet require distinction under the Act because of the divergence in what is covered between the two events”.⁸⁷

The leading UK case of *Young v Sun Alliance & London Insurance* stated that the term “flood” ought to be given its ordinary meaning:⁸⁸

It is because the word ‘flood’ occurs in the context it does, that I have come to the conclusion that one must go back to first impressions, namely that it is used there in the limited rather than the wider sense; that it means something which is a natural phenomenon which has some element of violence, suddenness or largeness about it.

While it is noted that subsequent cases have diverged from the approach in *Young* by holding that flood can include the slow ingress of water without a natural cause,⁸⁹ to attract EQC cover the flood has to constitute a natural disaster.

Where there is a mix of mud and water inundation of a property, it may be difficult to determine if the event is a flood or a landslip. The High Court has considered the meaning of ‘inundation’ and whether a landslip can fit within that definition. The case *Doyle v Earthquake Commission* considered whether the movement of debris or debris remaining on property could amount to an inundation. The Far North District Council had earlier registered a notice on the title under section 36 of the Building Act 1991,⁹⁰ stating that the land was subject to damage from inundation, erosion, and avulsion. The plaintiff subsequently bought the property. Between 27 and 29 March 2007, the Far North district experienced a 1-in-150-year rain event, resulting in damage to Mr Doyle’s property from the movement of a landslip and debris remaining on the property. The EQC declined cover on the basis Mr Doyle could have reasonably been taken to have assumed the risk of damage as listed in the section 36 notice.⁹¹

Justice Hugh Williams relied on dictionary definitions, common meaning, and analogy to find that inundation could apply to fluid debris, although in a static state.⁹² Therefore, the slurry of rainwater, dirt and vegetation could be properly regarded as ‘slippage’ or ‘falling debris’ while

⁸⁷ Above n 85, at 14-15.

⁸⁸ *Young v Sun Alliance & London Insurance Ltd* [1976] 3 All ER 561 at 564.

⁸⁹ Merkin, above n 55, at 15.3.3(3). Note also that in an effort to reconcile these decisions, the accepted test in the United Kingdom is now a list of factors for informing what is regarded as a matter of judgment see *Board of Trustees of the Tate Gallery v Duffy Construction Ltd and anor* [2007] 1 All ER (Comm) 1004 at [37].

⁹⁰ *Doyle v Earthquake Commission* [2009] NZRMA 546 at [1].

⁹¹ At [7].

⁹² At [61].

in motion but became inundation when at rest.⁹³ Justice Williams stated that inundation could apply to fluid other than water such as milk, cement and heavier-than-air gas without violence to the meaning.⁹⁴ As Mr Doyle was taken to assume damage for inundation by virtue of the notice, he was not covered for costs to remove the slurry; however, he was able to recover for any damage from the slurry while it was in movement, as EQC could only decline cover for the natural hazards identified in the notice.

Another illustration of a situation where a flood and a landslip were hard to distinguish between is the 2017 Edgumbe flood. On 6 April 2017, the Rangitāiki River broke its urban flood wall, or stop-banks, and flooded houses in the town of Edgumbe. Fifteen homes were permanently destroyed, and 250 were badly damaged. By April 2018, 78 homes were still awaiting repairs and uninhabitable.⁹⁵

Properties next to the earthen flood wall may have been subject to a landslip from that stop-bank/flood wall itself as well as to a flood from the river water, whereas those further away may have been subject only to flooding from the river water (albeit ‘dirty’ floodwater –water with some sediment suspended in it). If so, these homeowners would be entitled to different levels of compensation from EQC. All affected properties had damage from muddy water; the difference would be in the concentration of mud or sediment in the water. The type of damage suffered was very similar and not many would agree that properties should be treated so differently from the same event.

Residential land and buildings

Natural disaster damage must be to residential land or buildings (in the case of landslip).

“Residential building” is defined as comprising one or more “dwellings”. A “dwelling” is:⁹⁶

any self-contained premises which are the home or holiday home, or are capable of being and are intended by the owner of the premises to be the home or holiday home, of 1 or more persons.

⁹³ At [63].

⁹⁴ At [61].

⁹⁵ Andrew McRae “A year after Edgumbe floods: 78 homes still unoccupied” *Radio New Zealand* (6 April 2018) <www.rnz.co.nz>

⁹⁶ Earthquake Commission Act, s 2 definition of “Residential building” and “dwelling”.

Outbuildings such as garages, sheds and other appurtenant structures are covered where they are used for the purposes of the household.⁹⁷

Buildings or parts of buildings providing long-term accommodation for the elderly are “residential buildings” if the area of the building providing the accommodation comprises fifty per cent or more of the total area of the building, part, or structure.⁹⁸

Commercial premises, such as hotels, are not covered, except for staff and manager accommodation, which are residential buildings. Serviced apartments and timeshares are not usually covered, except for owner-occupied apartments and self-contained manager’s accommodation.⁹⁹

While holiday homes are explicitly provided for in the Act, they are not core to EQC’s stated purpose of helping households recover from disaster. On this basis, the more expansive reading of the Act given in the *Morley* case, which expanded coverage to boarding houses, appears to be less appropriate for holiday and other temporary accommodation.¹⁰⁰

Residential land is property within the land holding on which the insured residential building is situated, as follows:¹⁰¹

- the land under the building
- all land within 8 metres in a horizontal line of the building
- certain bridges and culverts
- land within 60 metres in a horizontal line of the building that constitutes or supports all or part of the main access way to the building, and all retaining walls and their support systems within 60 metres in a horizontal line of the building that are necessary for the support or protection of the building.

A diagram showing the practical application of land cover is at [Appendix 1](#).

⁹⁷ Earthquake Commission “EQ Cover: An Insurers Guide” (September 2012) <www.eqc.govt.nz>

⁹⁸ Above, n 97.

⁹⁹ Earthquake Commission “EQ Cover: Insurers’ Guide” (February 2019) <www.eqc.govt.nz>

¹⁰⁰ *Morley v Earthquake Commission* [2013] NZHC 230.

¹⁰¹ Earthquake Commission Act, s 2 definition of “residential land”.

The *Earthquake Commission v Insurance Council* case states that building foundations are excluded from land damage. In discussing land subsidence, the High Court stated that:¹⁰²

Where there has been physical damage to land resulting in subsidence, but there has been no change to the physical state or integrity of the structure or materials that comprise the body of the house erected on the land including its foundations, we consider that this should be regarded as damage to the residential land, not to the residential building.

The Treasury has stated that “the complexity of land cover creates a number of problems”,¹⁰³ including that:

- The distinction between building foundation works and land works needed to reinstate or replace the dwelling (and therefore between the land cap and the building cap) is disputed
- Certain provisions, including the area and maximum value of cover, and treatment of ‘appurtenant’ structures such as garages and sheds, can result in unintentionally unfair outcomes in some cases.

It proposes that there is a need for clearer or revised definitions of key concepts, including what constitutes land damage and the standard of reinstatement necessary to satisfy EQC’s obligations.

Access ways, bridges and culverts

To attract cover, an access way must constitute the main access way or part of the main access way, therein excluding cover for other roads and paths, such as a bridge providing access to the beach that is more than eight metres from the dwelling.¹⁰⁴ While the land supporting the access way is covered, the hard surface is not.¹⁰⁵

Prior case law dealing with an access way across neighbouring land found that an easement across neighbouring land rather than exclusive title could suffice.¹⁰⁶ The definition of “residential land” includes specific objects that are “part of the land holding” provided they are within 60 metres of the building.¹⁰⁷ The meaning of “land holding” was found by the High Court to be broader than the parcel of land over which the claimant had title.¹⁰⁸ This was further supported

¹⁰² Above n 63, at [87].

¹⁰³ Treasury, above n 8, at 28.

¹⁰⁴ Earthquake Commission Act, s 2 definition of “residential land”.

¹⁰⁵ Earthquake Commission “Land” (22 March 2018) <www.eqc.govt.nz>.

¹⁰⁶ *Earthquake Commission v Winch*, above n 63.

¹⁰⁷ Earthquake Commission Act, s 2 definition of “residential land”.

¹⁰⁸ *Earthquake Commission v Winch*, above n 63, at [27].

by the finding that Parliament would not have intended landlocked claimants to have no coverage for their access ways under the Act,¹⁰⁹ and that lay persons would not conceive of their property as excluding an access way.¹¹⁰

Bridges and culverts are covered if they are within 8 metres of the house, or within 60 metres if forming part of the main access way.¹¹¹ This property may be at significant risk in the event of a flood or storm because its primary function is to interface with water. In replacing such property, EQC may require they be strengthened or relocated.¹¹²

Retaining walls

Retaining walls are not specifically defined in the Act but are described as being “necessary for the support or protection” of buildings and other property such as access ways.¹¹³ Retaining walls and their support systems must be located within 60 metres of the building to attract cover. Support systems may not need to be situated entirely on the property that they serve, although they would probably need to “retain” the land that constitutes the main parcel.¹¹⁴

A sea wall would be a retaining wall if it retained the earth behind it as well as interfacing with the sea, and it would be covered if it was within the same land holding as the insured residential building. Sea walls located outside the owner’s land holding (eg, within a foreshore area) would not be covered.¹¹⁵

Physical loss or damage

The Act provides cover for physical loss or damage, including imminent loss or damage as a direct result of a natural disaster¹¹⁶ and loss or damage caused by measures taken to mitigate or avoid further consequences of the disaster (eg, water damage incurred by firefighting). Consequential losses (such as theft or loss of profits) are not covered.¹¹⁷

¹⁰⁹ *Earthquake Commission v Winch*, above n 63, at [26].

¹¹⁰ At [28].

¹¹¹ Earthquake Commission Act, s 2 definition of “residential land”.

¹¹² EQC Act, sch 3, s 10.

¹¹³ Earthquake Commission Act, s 2 definition of “residential land”.

¹¹⁴ This is a plausible extension of the finding in *Earthquake Commission v Winch*, above n 63. Other preconditions would probably include that the neighbouring owners cannot make a claim, and that the wall is subject to some kind of legal interest (such as a covenant).

¹¹⁵ Dr Hugh Cowen, above n 31.

¹¹⁶ Earthquake Commission Act, s 2 definition of “natural disaster damage”. See also *Kraal v Earthquake Commission*, above n 63.

¹¹⁷ Earthquake Commission Act, sch 3 cl 2.

Three types of damage or loss caused by natural disaster are therefore covered – ordinary physical loss or damage, damage caused by mitigation or containment measures, and imminent loss or damage.

What constitutes physical loss or damage?

The case of *He v Earthquake Commission* confirmed that damage must be “material”. In that case, the Court found that the damage complained of was “so insignificant when the general state of the exterior was considered, [it] could not be considered to constitute damage for the purpose of a claim.”¹¹⁸

Increased flooding vulnerability (IFV) land damage, where that damage has been caused by a natural disaster, is covered by EQC. In *Earthquake Commission v Insurance Council of New Zealand*, the Commission sought declarations including as to whether it is liable for damage to residential land that results in IFV. The Court found that:¹¹⁹

As a direct result of the earthquakes, there has been a disturbance to the physical integrity of the land, reducing it in volume and leaving the body of the land in a changed physical state. ... The criteria for physical loss or damage are satisfied. We conclude that Increased Flooding Vulnerability constitutes natural disaster damage to insured residential land for the purposes of the Act.

It follows that cover could be given for any damage to land which reduces the use and amenity of the land to the extent that it becomes “less suitable as a building platform and for the other purposes usually associated with residential land”.¹²⁰

The meaning of “physical loss or damage” was thoroughly tested by the Courts during the Canterbury earthquakes due to consequential losses from regulatory measures passed in the wake of the disasters. These included the creation of the red zone and passing of notices under section 124 of the Building Act 2004 declaring buildings unsafe.

The first major decision was *O’Loughlin v Tower Insurance Ltd*.¹²¹ In that case the plaintiffs claimed that the creation of the red zone was a type of physical loss or damage for the purposes of an insurance contract with Tower Insurance – an insuring clause that closely resembled the one under the Act. The red zone involved the government offering to purchase property in certain areas of Christchurch deemed unsafe for residential development. This was

¹¹⁸ *He v Earthquake Commission* [2017] NZHC 2136 at [166].

¹¹⁹ Above n 63, at [79].

¹²⁰ At [92].

¹²¹ *O’Loughlin v Tower Insurance Ltd* [2013] NZHC 670, [2013] 3 NZLR 275.

accompanied by statements that public services would be gradually withdrawn from the areas. The announcement and implementation of the red zone strategy caused property values in red-zoned areas to drop sharply.

To make this argument, the plaintiffs relied on cases from the United States which adopted a more expansive notion of “physical” damage. This was firmly rejected by the High Court:¹²²

United States cases [have] held that, where a ... regulatory response [has] rendered a product unsaleable, damage has occurred. ... There is a similar line of cases that indicates that when a property suffers no damage but becomes subject to a potential threat, for instance falling rocks or landslides, this is treated as being physical damage. The fact that a structure cannot be used as a dwelling in the sense that rational persons would be content to reside there, is relevant to the conclusion that there must be damage. I do not consider these authorities of assistance in the New Zealand context. ... The red zone designation caused no physical damage and there is nothing in the context or background circumstances to suggest a different interpretation. There is no ambiguity.

The Court concluded that the same reasoning applied to physical loss as to physical damage.¹²³

The Court also commented that an expansive definition of physical damage to include administrative and regulatory decisions in the aftermath of a natural disaster would have almost unlimited application, and therefore would not make sense for a commercial insurer to offer.¹²⁴

The findings in *O’Loughlin* were subsequently applied in the Court of Appeal decision *Kraal v Earthquake Commission*,¹²⁵ a claim for loss to a residential building. The claimant’s home was in the vicinity of a rock face which had been damaged in earthquakes. An engineer’s report showed that the rock face was likely to collapse, and that the claimant’s home would be directly in its path. The council issued an order pursuant to section 124 of the Building Act 2004, making it illegal to occupy the building within five years or earlier if the risk ceased. Kraal argued that this constituted physical loss because she was being physically deprived of her property. EQC asserted that the Building Act order could not constitute physical loss because, while the order had caused a loss to Kraal in terms of access, it had not physically damaged the property itself. This argument succeeded in the High Court, and was upheld in the Court of Appeal:¹²⁶

¹²² At [47]-[51] (emphasis added, and footnotes omitted).

¹²³ At [52].

¹²⁴ At [80] (emphasis added).

¹²⁵ Above n 63.

¹²⁶ Above n 63 at [41].

...it is loss or damage that reaches and touches the house and not loss or damage to objects other than the property, such as the insured person or that person's enjoyment of the property, that is covered. It was open to those who drafted the definition if they wished to cover loss in its broadest sense to use the phrase loss "of" the property, and to avoid prescriptive words such as physical. But they did not do so. They specified "physical" loss "to" the property.

The house had actually been damaged by the earthquakes,¹²⁷ but the Court noted that it had not been damaged as a result of destabilisation of the rock face.¹²⁸ The Court's decision was essentially that a prohibition notice could not constitute physical damage.

The Court also commented that the meaning of physical loss or damage ought to be construed narrowly because Parliament had included a narrow exemption to the requirement for physical damage, through the specific inclusion of "imminent" loss or damage.¹²⁹

The fact that the cover was so extended indicates that loss of possession and economic loss of the types that arise in the appellants' claim, where there is no actual physical loss or damage, were not considered by the legislature to be covered.

The Court of Appeal, following the reasoning in *O'Loughlin*, rejected the application of the expanded notion of physical loss or damage that had been accepted in certain North American states.¹³⁰

Imminent physical loss or damage

Physical loss or damage includes damage to land that is "imminent as the direct result of a natural disaster which has occurred".¹³¹ "Imminent" is interpreted by EQC to mean an event has a fifty percent chance of occurring within one year.¹³²

In *Kraal*, it was accepted by the claimant that "the prospect of rock falling and hitting the property was not expected to occur within the next 12 months and was therefore not "imminent"". ¹³³

¹²⁷ At [4]-[5].

¹²⁸ At [42].

¹²⁹ At [49].

¹³⁰ At [72], [78].

¹³¹ Earthquake Commission Act, s 2 definition of "physical loss or damage".

¹³² Michalik, above n 62, at 19.2.

¹³³ Above n 63, at [9]

Physical loss or damage caused by mitigation or containment measures

Physical loss or damage that occurs as a result of measures to contain or mitigate the consequences of a natural disaster is covered by EQC. These measures must be undertaken under proper authority; an example is damage caused by Urban Search and Rescue teams entering residential buildings to search for survivors after an earthquake.¹³⁴

¹³⁴ Earthquake Commission “EQC Claims Manual for Insurers” (28 September 2017) <www.eqc.govt.nz>

Settling claims

Methods of settlement

Three methods of settlement are specified in the main body of the Act: payment, replacement and reinstatement.¹³⁵ A further option, relocation, is set out in the third schedule.¹³⁶

EQC has the right to elect the method.¹³⁷ This enables EQC to adopt an approach tailored to the specific circumstances. For example, after the Canterbury earthquakes EQC adopted a policy of settling claims of less than \$10,000 by financial payment. For claims up to the statutory cap of \$100,000, EQC engaged Fletchers Construction to carry out replacement or reinstatement work unless the claimant wished to engage their own contractor.¹³⁸ After the Edgecumbe flood, EQC took “a different approach than EQC would typically take following such a natural disaster”, including working with local councils and contracting companies to clear silt and debris from underneath and around people’s properties.¹³⁹ Following a landslip in Dunedin, EQC provided a cash settlement which each claimant was responsible for using to cover the cost of repairs.¹⁴⁰

Ultimately, EQC needs to establish that their decision on the method of settlement is the most appropriate in the circumstances.¹⁴¹ In *Earthquake Commission v Insurance Council of New Zealand*¹⁴² the High Court was asked for a declaration on the legality of EQC’s internal policies for settling damage to land caused by IFV due to land subsidence, and increased vulnerability to liquefaction.¹⁴³ In the case of IFV, the Court noted that repair by raising the height of the land would often be impractical due, for instance, to the need to temporarily remove buildings, the fact that intensive earthworks could cause flooding of neighbouring properties, and the fact that

¹³⁵ Section 29(2).

¹³⁶ Schedule 3, Cl 9.

¹³⁷ Section 29(2). For a discussion of the doctrine of election in insurance law and its application to the Act, see *C & S Kelly Properties Ltd v Earthquake Commission* [2015] NZHC 1690.

¹³⁸ Jeremy Finn “Insurance Issues” in Jeremy Finn and Elizabeth Toomey (eds) *Legal Responses to Natural Disasters* (Thompson Reuters, Wellington, 2015) 195 at 10.2.

¹³⁹ Earthquake commission “EQC continues its success in helping Edgecombe” (22 September 2018) <www.eqc.govt.nz>

¹⁴⁰ Earthquake Commission “EQC completes settlements for the Dunedin landslip claims” (21 March 2019) <www.eqc.govt.nz>

¹⁴¹ *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [112]: “repair or reinstatement will not always be an available or appropriate response...The Commission has flexibility under the Act to tailor the indemnity response to meet the particular circumstances of any given case.”

¹⁴² Above n 63.

¹⁴³ At [106].

resource consents may not be attainable.¹⁴⁴ For this reason, the Court held that settlement of claims on a diminution of value basis, as provided for under EQC's policy, could be an appropriate form of settlement.¹⁴⁵ It noted the potential for disproportionate cost, and the ability for the insured to receive a windfall if costs of repair were available as of right:¹⁴⁶

Where, for example, a claimant has no intention of carrying out repair or reinstatement works to residential land suffering from Increased Flooding Vulnerability because this is neither technically feasible nor lawful, the claimant would be overcompensated if he or she received the estimated costs of such repairs to the extent that these exceed the diminution in value of the property.

The Court stated:¹⁴⁷

The appropriate indemnity response will be a question of fact to be determined in the particular circumstances of each case. The claimant's intention to carry out repairs and the feasibility of these repairs will be relevant. There may be cases where repair costs are disproportionate and unreasonable in all of the circumstances. That question can only be judged on a case by case basis. We can go no further than to state that proportionality, and the consequent reasonableness of repair costs, will be a relevant consideration that the Commission should take into account.

While costs of repair could be cheaper than compensating for market diminution, such costs cannot be calculated by assessing the costs of repairing another asset – for instance, repairing a residential building in order to repair damage to land. For example, in *Earthquake Commission v Insurance Council of New Zealand* the High Court rejected the argument that land subsidence causing vulnerability to floods could be indemnified by paying the cost of raising the height of a residential building:¹⁴⁸

The Act separately insures residential land and residential buildings against natural disaster damage. Where claims are to be met by repair or reinstatement, this must be repair or reinstatement of the insured property, in this case the residential land. Residential land is not repaired or reinstated if all that has happened is a modification to the residential building.

¹⁴⁴ At [95]-[97].

¹⁴⁵ At [114].

¹⁴⁶ At [112].

¹⁴⁷ At [120].

¹⁴⁸ At [122].

The Court also makes clear that repair payments based on damage to particular property must be used to repair that property.

Payment

EQC has the option of “paying the amount of the damage”.¹⁴⁹ Different formulas are used for land as to buildings. The formula for land value is set out in the statute as being smallest value of:¹⁵⁰

- the area of land actually lost or damaged;
- an area of land equal to the minimum area allowable under the district plan for land used for the same purpose that the residential land was being used at the time of the damage;
- an area of land of 4,000 square metres.

The value, therefore, may be smaller than the cost of repairing the land.

Bridges, culverts, and retaining walls and their support systems are insured at indemnity value.¹⁵¹

It has been noted that EQC has accounted for land in need of extensive remediation as a percentage of the area land lost from the total. For example, five per cent of a section worth \$200,000 may be lost, entitling the owner to \$10,000, whereas the full cost of repairing or securing the section could be over \$100,000.¹⁵² Michalik and Boys suggest that EQC should not be able to restrict damage to land in this way, noting that the High Court in *Earthquake Commission v Insurance Council* stated that, first, the Act has an emphasis upon repair and reinstatement¹⁵³ and, secondly, that EQC ought to take into account the reasonableness and proportionality of repair costs when deciding how to settle a claim.¹⁵⁴ Such a method would appear to offer lower levels of compensation than the diminution of value, and could be in conflict with the requirement to “pay the amount of the damage” to the property.¹⁵⁵ However, it seems that these statements from the High Court were meant to be observed in reverse: to allow EQC to make a payment for the diminution of value when repair costs were out of

¹⁴⁹ Earthquake Commission Act, s 9(1).

¹⁵⁰ Section 19(a).

¹⁵¹ Section 19(b).

¹⁵² This example was borrowed from Michalik, above n 62, at 19.4.

¹⁵³ *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [111].

¹⁵⁴ At [122].

¹⁵⁵ Earthquake Commission Act, sch 3, cl 9(1).

proportion but under the statutory cap. There is no reasonable interpretation of the section which allows for payment in excess of the land value.

The amount of the damage may be different from the cost of reinstatement – eg, repairing the asset. This means EQC may pay for the diminution of value in the asset,¹⁵⁶ or potentially, the value of the land lost.¹⁵⁷ The diminution of value may also take account of the cost of repairing another asset – eg, the cost of raising a residential building.¹⁵⁸

A consequence of limiting “residential land” to value lost and/or indemnity value is that any mitigation required under new regulatory standards is not covered. This is because improvements under enhanced regulatory standards are only covered when the item is covered to replacement value.

Buildings are insured to replacement value, up to the monetary cap. Replacement value means any costs which would be reasonably incurred in respect of:¹⁵⁹

- demolition and removal of debris, to the extent that is essential to enable the building to be replaced or reinstated; and
- replacing or reinstating the building to a condition substantially the same as but not better or more extensive than its condition when new, modified as necessary to comply with any applicable laws; and
- complying with any applicable laws in relation to the replacement or reinstatement of the building; and
- other fees or costs payable in the course of replacing or reinstating the building, including architects’ fees, surveyors’ fees, and fees payable to local authorities.

In *Earthquake Commission v Insurance Council*, the High Court held that the express reference to residential buildings and personal property in the definition of “replacement value”, and the absence of any reference to residential land, shows that residential land was not intended to be covered under this definition:¹⁶⁰

¹⁵⁶ *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [114].

¹⁵⁷ Michalik, above n 62, at 19.4.

¹⁵⁸ *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [118].

¹⁵⁹ The full definition also includes cover for personal property. However, pending reforms are going to remove personal property from being covered under the Act. See *Earthquake Commission Amendment Act* sch 2.

¹⁶⁰ At [106].

“Replacement value” is defined in s 2 of the Act with reference to residential buildings and personal property but there is no comparable provision for residential land, including retaining walls, bridges and culverts. These provisions show that Parliament drew a distinction between the indemnity available under the Act in respect of residential land and that provided for residential buildings and personal property.

It also noted that “replacement value” is not mentioned in the definition of “residential land”, and the legislative history of the Act shows that separation of cover for land and buildings was intended to differentiate the types of cover.¹⁶¹ This was held to support an argument for residential land being insured on an indemnity basis, which is a conclusion that the Court makes clear elsewhere in the judgement.¹⁶² However, the Court also noted that EQC could not always discharge its obligations by simply compensating for loss of market value,¹⁶³ because the specification of three settlement options (payment, replacement and reinstatement) suggested that repair and reinstatement costs must be available in “appropriate cases”.¹⁶⁴ The Court stated that:¹⁶⁵

The appropriate indemnity response will be a question of fact to be determined in the particular circumstances of each case.

Indemnity value was considered in *Michalik v Earthquake Commission*:¹⁶⁶

The principle then is that indemnity value is the actual loss suffered, not the cost of new for old if that involves more than the actual loss. The relevant value can only be the value of the item immediately before loss or damage taking into account its age and condition and therefore its likely remaining life.

The case concerned the appropriate quantum to be paid out for landslip damage to a retaining wall. The plaintiff alleged that EQC was required to replace the damaged wall with a new wall that met current regulatory requirements; the result would be a wall that was better than that owned prior to the damage occurring.¹⁶⁷ This argument was rejected in favour of EQC’s

¹⁶¹ At [107]-[108].

¹⁶² At [94].

¹⁶³ At [108]-[110].

¹⁶⁴ 381 at [110]: “The Act contemplates that the Commission may settle claims for natural disaster damage to residential land by meeting repair or reinstatement costs in appropriate cases. The Commission’s option of replacing or reinstating damaged property, instead of paying the amount of the damage, applies to all insured property, including residential land.”

¹⁶⁵ At [122].

¹⁶⁶ *Michalik v Earthquake Commission* [2014] NZHC 2238 at [53].

¹⁶⁷ At [2].

provision of the “depreciated replacement cost”.¹⁶⁸ This example highlights a key difference between replacement value and indemnity value: replacement value can include paying the cost for the asset to meet updated regulatory standards, thereby providing an asset that is better than the one previously owned by the claimant.

Michalik also confirms that depreciation in the value of the asset can be a useful proxy for estimating the condition of an asset in the absence of other evidence.¹⁶⁹

Replacement and reinstatement

Replacement and reinstatement are described with the following limitations:¹⁷⁰

- Replacement and reinstatement need only be as circumstances permit and in a “reasonably sufficient manner”;
- Where the damage is to land, and consists of or results in debris on the land, EQC is only required to remove the debris.

The claimant must provide plans or specifications, etcetera, to assist EQC to determine if it will elect to replace or reinstate.

Direct physical reinstatement involves the insurer taking responsibility for directly carrying out or contracting out the task of repairing an asset. Liability for the standard of work rests with the insurer, as does any eventual cost of repairs.¹⁷¹ This method seems unlikely to be used frequently in the future; the decision to directly physically reinstate property after the Canterbury earthquakes proved to be controversial due to delays in completing repairs and complaints about the quality of the work.¹⁷² The Chairman of EQC, Sir Maarten Wevers, noted that “... repairing houses is not, and never has been, part of the Earthquake Commission’s role, and we embarked on that pressing national need from a standing start.”¹⁷³

¹⁶⁸ At [48].

¹⁶⁹ At [53].

¹⁷⁰ Earthquake Commission Act, Sch 3, Cl 9.

¹⁷¹ See for instance *O’Loughlin v Tower Insurance Ltd*, above n 122, where it was held that Tower Insurance’s repair method for direct physical reinstatement would not work, and that the insured was therefore entitled to pay for the full cost of replacing the property.

¹⁷² RNZ Checkpoint “EQC considering legal action against Fletcher Construction” (8 March 2018) Radio New Zealand <www.rnz.co.nz>

¹⁷³ Madison Northcott “Letters reveal spat between minister and EQC chairman” Stuff <www.stuff.co.nz>

Relocation

The option of relocation is set out in Schedule 3 of the Act, which states that EQC may relocate buildings within the same site or to a reasonably equivalent site. This option requires EQC to pay all costs of relocation, reinstate the building to the same condition it was in prior to the natural disaster and, where the building is moved to a different site, provide the claimant with the same kind of legal right or interest in the site as they had in the previous site (with the previous site being transferred to EQC). To the best of our knowledge there are no cases addressing the issue of relocation.¹⁷⁴

Grounds for limiting or cancelling cover and declining claims

EQC has power to cancel or limit coverage and decline claims. The scope of this power requires a balancing act. On one hand, EQC is bound to insure persons who purchase fire insurance, and therefore requires a means of reducing the moral hazard caused by insurance being available as of right, such as by declining claims in some circumstances. On the other hand, EQC provides cover for risks that private insurers will not ordinarily cover, leaving no alternative avenues for claimants; this suggests limiting the power to decline cover and claims.

The Act requires that certain circumstances be present before cover may be declined. The Act includes specific sections addressing cancellation, limitation, and a limited set of reasons for declining claims. Notably, a duty on claimants to mitigate is written into the Act,¹⁷⁵ but is not listed as a basis for declining claims and/or cancelling or limiting cover. Rob Merkin suggests that this duty is limited to instances where a failure to mitigate can be identified as the proximate cause of the loss; this will be uncommon in cases of natural disasters and thus the section is unlikely to be used.¹⁷⁶

¹⁷⁴ No cases were found in the course of research, see Courts of New Zealand “Earthquake List Canterbury” <www.courtsofnz.govt.nz> for a full list.

¹⁷⁵ Schedule 3, cl 12

¹⁷⁶ Above n 55, at 15.4.12.

Circumstances where Commission may decline claim

The Commission may decline, or meet only part of, claims on the following grounds:¹⁷⁷

- Previous payments made by the Commission were not used to repair damage, resulting in greater loss than would have otherwise occurred in a subsequent event.
- The insured failed to comply with laws or bylaws and that failure exacerbated the natural disaster damage – for example, undertaking building works that do not meet the requirements of the Building Act 2004 and that subsequently fail during a natural disaster.
- The residential building and/or structures on the land were not constructed in accordance with appropriate standards and the failure to meet those standards causes or exacerbates natural disaster damage.
- The title to the property contains an entry under the Building Act 1991 or 2004, identifying a natural hazard. Under section 72 of the Building Act 2004, a building consent must be granted in certain circumstances even though the building will be subject to natural hazards. This limited provision is subject to a series of conditions, one of them being that the stated hazards are registered on the title pursuant to section 74.¹⁷⁸

The Building Act 2004 specifies erosion, flooding and storm surge in the definition of natural hazards, amongst others in an exhaustive list.¹⁷⁹ EQC is entitled to decline a claim when damage is a result of the hazards specified in the notice, but is not entitled to decline a claim solely on the basis of a section 74 notice.¹⁸⁰

These Building Act notations allow people to build in vulnerable areas if they voluntarily assume the risk. However, the process is reliant on the hazardous land at issue being identified as such through the building consent process. Failure to use this process and instead issue ordinary consents could expose the local authority to a claim of negligence.¹⁸¹

¹⁷⁷ Earthquake Commission Act, sch 3 cl 3.

¹⁷⁸ Building Act 2004, s 74. This notation attaches to the land even if subsequently subdivided. See also *Doyle v Earthquake Commission*, above n 90.

¹⁷⁹ Building Act, s 71(3).

¹⁸⁰ Above n 90.

¹⁸¹ One possibility is that EQC (or some future equivalent of the Canterbury Earthquake Recovery Authority) sues local government in negligence on a claimant's behalf in order to recoup losses.

Sections 71-74 of the Building Act 2004 do not provide for retrospectively declaring that land is subject to natural hazards. However, if reconstruction required a new consent then the notations could be added at the time of the new consent.

- **Fraud and misrepresentation:** the Act makes a distinction between fraud and wilful misdescription on one hand, and material misrepresentation on the other. Intentional misrepresentation and fraud will invalidate claims irrespective of whether the information is material to assessing the claim. Misrepresentations that are not intentional need to be material to estimating the value of the property if they are to found to be a basis for declining the claim.
- **Damage caused or contributed to by wilful or negligent act:** a claim can be denied if the damage was actually caused by a wilful or negligent act of the owner or former owner, or contributed to by such an act. In relation to sea-level rise, two types of action seem relevant: failing to maintain mitigation measures, and failure to implement mitigation measures. Of the former, an example would be a failure to maintain existing drainage systems, therein causing a flood. Another example would be failing to maintain existing retaining walls, therein causing increased damage or landslide. The latter might include the failure to install a drainage system, erect minor flood defences, or installing wholly inadequate mitigation measures. The inclusion in the Act of a duty to mitigate strongly suggests that a failure to mitigate can constitute negligence.¹⁸²

Cancellation of insurance

EQC may only cancel cover under the Act if money paid out by the Commission is not used to reinstate or replace the damaged property “to the satisfaction of the Commission”.¹⁸³ The fact of cancellation is registered against the title to the land and will not be lifted until the required work is undertaken.¹⁸⁴ This disincentivises non-compliers from on-selling, thereby protecting potential purchasers.¹⁸⁵ This section shows that, while monetary settlements are legally able to be used for whatever purpose the recipient chooses, there are significant consequences for those who chose not to undertake repairs. The section also shows that cancellation is a narrow power

¹⁸² Schedule 3, cl 12.

¹⁸³ Schedule 3, cl 4(1).

¹⁸⁴ Schedule 3, cl 4(2).

¹⁸⁵ Section 28.

under the Act. This makes sense in light of the fact that power to limit coverage allows a more targeted means of deterring moral hazard than the rather blunt mechanism of cancellation.

Commission may limit its liability

A separate power of the Commission is to limit the extent of cover it provides in a particular situation. Like cancellation, limitations of coverage are attached to the land and registered on the title.¹⁸⁶ As previously mentioned, the provisions for limiting cover are broader than those for cancellation, precisely because limiting coverage is a more targeted action.

There are two situations in which coverage can be limited. First, the Commission can issue a notice limiting its valuations of the property to present value when there is an imminent risk of a natural disaster. In other words, if a risk is imminent, the Commission can effectively notify the landowner that it will refuse to pay for subsequent improvements to the property, or for any increase in market valuation.¹⁸⁷

Secondly, EQC can limit its liability in respect of damage to the whole property or a particular part of the property where natural disaster damage has already occurred, is certain to recur, and could reasonably be or have been avoided.¹⁸⁸ It is unclear whether this section allows for coverage to be limited if a claim has already been declined in respect of the event. The section states that EQC must give notice of the decision to decline “any further claim”. Whether the first claim needs to have been successful is not clear.

Another issue is whether this section can require mitigation as a “reasonable” means of avoiding damage to the property. To reiterate, the inclusion in the Act of a duty to mitigate – namely, that the owner implement “reasonable precautions” - strongly suggests that a failure to mitigate is relevant to judging whether a course of action was reasonable.¹⁸⁹ This invokes the same issues that were raised in the above discussion of negligent or wilful acts: whether a failure to implement mitigation measures is unreasonable and, if so, how cost and other factors may affect this (eg, whether EQC should consider the cost of the repairs, or the financial means of the person or their preferences). It seems clear that maintaining one’s drains is a reasonable action to require, as is relocating an access way away from a flood path where a safe alternative is

¹⁸⁶ Earthquake Commission Act, sch 3, cl 5(4)-(5).

¹⁸⁷ Schedule 3, cl 5(1).

¹⁸⁸ Schedule 3, cl 5(2).

¹⁸⁹ Schedule 3, cl 12.

readily available. But installing an expensive new drainage system or erecting flood defences is less likely to be deemed reasonable.

Any decision to limit cover on the basis of a failure to undertake reasonable actions will require compliance with natural justice, given that an existing interest is being adversely impacted by the decision.

Other options for limiting, cancelling or declining cover

An additional basis for declining cover is where the contract of fire insurance itself is considered void due to a fraudulent representation or a failure to disclose material facts to the private insurer in breach of the duty of good faith.¹⁹⁰ If the fraud was wilful, then the discretion of the Commission to provide cover where a contract was reasonably thought to be in force would not be relevant.

An additional means of limiting or cancelling coverage is through the passing of regulations. Section 36 gives broad powers to the Governor-General to limit or remove future coverage for any type of residential land or buildings currently covered by the Act,¹⁹¹ or place significant conditions on the cover provided.¹⁹² Any changes to the regulations would have an instantaneous effect given that cover exists as described under the Act while the contract is in force. In other words, cover is not restricted to the wording of the Act at the time the contract was entered into; rather, cover exists to the standard specified under the scheme provided that a valid contract is in force.

¹⁹⁰ *State Insurance General Manager v McHale* [1992] 2 NZLR 399 (CA).

¹⁹¹ Section 36(1)(a).

¹⁹² Section 36(1)(b).

Potential impacts on EQC as a result of sea-level rise

Timing of responses to sea-level rise

EQC considers that there is a “time-bound dimension to managing the impacts of climate change”,¹⁹³ with the most significant impacts occurring in the next three to five years, after which “we would expect local and central government to use their planning, infrastructure investment and regulatory levers” underpinned by scientific research, to manage these effects. It rejects “a theme in public discourse that EQC is a social insurance scheme, or that insurance can play a primary role in funding and regulating pre-event resilience” and emphasises its role in post-event recovery by funding rebuilding and repair and providing “a buffer for the Crown balance sheet”.¹⁹⁴ If the impacts of sea-level rise do change over time as planning mechanisms are put in place, any role EQC plays in response to the current situation may be short-lived.

Does the notion of “normal” weather adjust upwards due to climate change?

Climate change and the associated increased frequency of storms and flooding raises the question of whether previously rare events which currently constitute natural disasters can be excluded from coverage over time. Can an increase in the average intensity of storms and related phenomena such as tides and waves alter what constitutes normal weather, capturing weather events that may have previously been considered storms as “the new normal”, and thereby take such events out of coverage? If a functional approach is taken, then EQC should only insure events that are unusual and unforeseeable. Natural disaster damage is currently contrasted with damage from erosion, for which the cause is the “normal” operation of the elements.¹⁹⁵

However, the answer to this question is surely that if the risk of certain events become too great – ie too certain -- they become uninsurable, regardless of whether they are considered natural disasters or normal weather events.

¹⁹³ Dr Hugh Cowen, above n 31.

¹⁹⁴ Above n 31.

¹⁹⁵ This is in keeping with the case land on water boundaries, for which changes in land due to erosion and accretion are excluded for sudden events such as storms or natural floods.

Could sea-level rise itself constitute a flood?

Tim Grafton from the Insurance Council of New Zealand recently commented on the insurability of damage caused by sea-level rise:¹⁹⁶

[Sea-level rise] is a very known event. ... The insurance sector insures accidental unforeseen losses. Sea-level rise is not accidental. It's not unforeseen. It's absolutely foreseeable so sea-level rise per se in damage to property is not covered by insurance.

Sea-level rise by itself cannot constitute a flooding event under the plain meaning of the words; it is gradual, not a single occurrence of water incursion. The Act clearly does not cover events on this timescale for the same reasons that insurance more generally cannot be relied on for addressing the majority of climate adaptation challenges:¹⁹⁷

[I]nsurance is not a fix-all adaptation option, because insurance is rarely suitable for climate risks that are slow to develop or for which other measures are required, such as rising sea-levels and ocean acidification or desertification.

Flooding from king tides not accompanied by a storm or landslip would also not be covered, because a king tide (even an exceptionally high one) is a normal event.¹⁹⁸

Protecting against future events

Adaptation, or “funding pre-event resilience”¹⁹⁹ not associated with previous disasters, is not a role of EQC. However, there are aspects to EQC’s role that do involve protection against future events, such as the requirement for claimants to have used previous payments to repair damage.²⁰⁰ Further, if EQC was able to change its approach to reinstatement and relocation, it could contribute to pre-event resilience within its current role.

Reinstatement

Reinstatement may include replacement or rebuilding of flood defences, for example. In such instances, it may make more sense to raise the height of a house above floodwater levels, rather

¹⁹⁶ Tim Grafton, Chief Executive of the Insurance Council of New Zealand, in the National Business Review *Property owners should brace themselves for higher-risk profile* (30 May 2019).

¹⁹⁷ Sofya Matteotti & Olga Nartova “Climate Change: Implications for the (Re)Insurance Industry” (2012) 10 NZJIL 107 at 122.

¹⁹⁸ Dr Hugh Cowen, above n 31.

¹⁹⁹ Above n 31.

²⁰⁰ Earthquake Commission Act, Sched 3 s 3(a).

than erecting a flood defence. This is an appealing alternative to providing a sum for the diminution of value without any obligation to invest in making the building more flood resilient.

However, addressing land damage through modification to buildings is currently excluded as a remedy.²⁰¹

The Act separately insures residential land and residential buildings against natural disaster damage. Where claims are to be met by repair or reinstatement, this must be repair or reinstatement of the insured property, in this case the residential land. Residential land is not repaired or reinstated if all that has happened is a modification to the residential building.

Because storm and flood coverage only applies to land damage, remediation paid for by EQC cannot include any modification of the building, including raising the building off the ground, or relocating the building away from an unstable hill or cliff. Also, damage to land cannot be compensated by paying for repairs to buildings, and vice versa.²⁰²

The dividing line between buildings and land is consequential when both the building and land have suffered significant damage. Damage to a building platform counts as land damage whereas damage to a building's foundations are damage to the building. In respect of storms and floods, damage to the land is covered but not damage to buildings. Therefore, if damage is classified as being to the land as a “building platform”²⁰³ rather than to a building’s foundations (which are not covered by EQC land cover,) it could keep the cost under the statutory cap for buildings. Repairing building foundations through upgrades may be cheaper overall compared to strengthening the land. Moreover, strengthening the “building platform” could overlap with strengthening the foundations. The quantum of EQC’s obligation is also complicated by the hard divide between land and buildings – EQC presumably cannot insist upon strengthening the foundations of a building as an alternative to expensive earthworks, although it has been able to pay for a diminution in land value in certain circumstances.²⁰⁴

According to Rob Merkin and The Treasury, cost shifting due to ambiguity between damage to land and damage to buildings was observable during the Canterbury earthquakes, and was

²⁰¹ *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [117] (emphasis added).

²⁰² At [122] “Residential land is not repaired or reinstated if all that has happened is a modification to the residential building”.

²⁰³ See definition discussed at [92].

²⁰⁴ Such as for increased flooding vulnerability and liquefaction vulnerability. See *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [108]-[110].

compounded by rezoning of properties to require strengthened foundations.²⁰⁵ The Treasury has therefore proposed a new category of cover be introduced for “siteworks”. This, combined with a revised approach allowing building modifications to be undertaken as part of land damage cover, could enable EQC to select a more appropriate remedy in certain situations. This could potentially be used to better provide for future inundation events due to sea-level rise.

Relocation

Theoretically, the remedy of relocation afforded to EQC could be used to support managed retreat from the coast after a natural disaster. This would only be applicable to landslip damage, not storms or floods, as those events are only covered in respect of land damage, not buildings. However, the costs of relocation are likely to always exceed the statutory building cap, and combined with the complexities of relocation, this means the remedy is unlikely to ever be used. EQC does not have a policy on relocation.²⁰⁶

It would be possible to create a presumption in favour of relocation for properties where recurrent flooding, cliff/hill instability, or sea-level rise threat is a significant issue. This would be more in keeping with climate change adaptation policy, especially where moving the house would remove the need for hard defences. Saving money through upfront investment in adaptation, to mitigate future damage, also accords with the Act’s purpose in reducing the Crown’s fiscal liability.

Imminent damage

The discussion in *Kraal* highlights a possible gap in the current legislation between safety orders prohibiting re-entry to a house, physical damage or loss, and imminent damage under the Act:²⁰⁷

It seems that at that time there was no equivalent power to that now provided by s 124 of the Building Act 2004 specifically in relation to off-site hazards which threaten buildings. That suggests, as EQC submits, that what has occurred in the present case was not expressly contemplated in the drafting of the Act. It may be that if the drafters had contemplated the present circumstances they may have wished to provide cover for it. It would be reasonable to think that the Act should provide cover to people who are

²⁰⁵ Rob Merkin “The Canterbury Earthquakes Insurance and Reinsurance Issues” (2012) 18 Canterbury L Rev 119 at 132. See also Treasury, above n 8, at 28.

²⁰⁶ Verbal communication from EQC.

²⁰⁷ Above n 63 at [49].

disposed of their property (that is, forced to leave it and not permitted to occupy it) because of a natural disaster.

The High Court's comments related to the limited meaning of 'imminent'. A similar fairness argument could be made for cover to be available when buildings are given a designation that prohibits entry indefinitely. However, in *Kraal* the claimant had already received an offer from the government to purchase her red-zoned property at its 2007 value.²⁰⁸ In other words, gaps in the EQC scheme with respect to what constitutes "natural disaster damage" might better be filled by a managed retreat policy than one funded through an insurance scheme.

An exception may be where a storm or flood has destroyed a natural barrier or major seawall beyond repair, exposing the property to imminent peril – assuming that more major storms are deemed a short-term certainty. However, such a scenario is unlikely to be seen as sufficient for EQC to pay out for land damage in advance of it actually occurring. It appears that imminent damage must either make the residence unsuitable for reoccupation (eg, a retaining wall or cliff holding up the house is likely to collapse if another storm or flood occurs, destroying the land under the house), and/or must be readily preventable through a type of mitigation that EQC would be obliged to pay for. This makes the current scheme unable to be used to compensate landowners to retreat from the coast in advance of damage that makes the house uninhabitable.

Increased flooding vulnerability

A finding of IFV requires physical damage to land as a result of a natural disaster, creating a heightened flood risk and a depreciation in the suitability of the land for residential development.²⁰⁹ Arguably, this extends land damage cover beyond the primary objective of the scheme by providing for the diminution in property value.

Further, sea-level rise could increase the likelihood of IFV if earthquakes were to decrease the relative height between residential land and the sea, as occurred during the Canterbury earthquakes. There is also evidence to suggest that liquefaction events are more likely due to sea-level rise.²¹⁰

²⁰⁸ Above n 63, at [15].

²⁰⁹ See *Earthquake Commission v Insurance Council of New Zealand*, above n 63.

²¹⁰ JL Risken and others "Implications of Sea-level Rise on Liquefaction Vulnerability in Canterbury" (Paper Presented to the 6th International Conference on Earthquake Geotechnical Engineering, November 2016).

IFV could also affect low-lying property. If a sea wall or natural barrier is destroyed by a storm surge, then a property may theoretically be subject to IFV.

A further detail from *Kraal* is how the Court sought to reconcile this finding with the earlier High Court decision in *Earthquake Commission v Insurance Council of New Zealand*, which held that increased vulnerability to flooding and liquefaction could constitute damage to land, and ought to be compensated through the loss in market value.²¹¹ The Court of Appeal held that “economic loss that does not stem from physical damage is not covered”.²¹² Under this approach, increased costs of repairs due to a change in building or planning policy is relevant for deciding the quantum necessary to compensate a claimant. However, a decision that prevents the land from being reoccupied for reasons other than the physical damage already incurred cannot constitute physical damage under the Act.

General subsidence

The section 2(1) definition of natural landslip “does not include the movement of ground due to below-ground subsidence, soil expansion, soil shrinkage, soil compaction, or erosion”. This does not exclude the possibility that a flood event could cause the land to subside, causing IFV.

Increased vulnerability to natural landslip

The reasoning applied to IFV could apply to risk of future landslip, if damage to residential land had occurred.

Ambiguities

Legislative ambiguities and incentives for cost shifting may feature in future claims over damage caused by storm, flood and natural landslip. Private insurers could be incentivised to classify flood damage as landslip damage, so as to pass a portion of the bill to EQC for major weather events.

²¹¹ Above n 63.

²¹² *Kraal v Earthquake Commission*, above n 63, at [73].

Economic loss

In the High Court case of *Earthquake Commission v Insurance Council of New Zealand*, increased flooding vulnerability and liquefaction vulnerability were deemed to be damage as per the Act, provided that physical damage to the land has occurred.²¹³ Rob Merkin takes this as authority that economic loss can be recovered for under the Act provided it stems from physical damage.²¹⁴ This mirrors the principles of ordinary insurance law. However, the methods for reinstating damage to land of this type are relevant to likely sea-level rise damage. The case involved EQC seeking a declaration as to the validity of their method for assessing increased flooding vulnerability and liquefaction vulnerability. It was accepted that in some cases, remediation of land to reduce flooding vulnerability through raising the land would not be reasonable,²¹⁵ and therefore that payment for diminution of value would be appropriate.²¹⁶

Inefficiencies caused by the interface between EQC and insurers

After the Canterbury earthquakes, some interactions between EQC and private insurers became a source of friction, including between claimants and reinsurers. This was partly due to the lack of protocols to reduce administrative uncertainty and double-handling. These issues were forecasted by a report in 2009.²¹⁷ The Treasury notes that a common suggestion is for private insurers to take over claims handling, which is technically already permitted under the statute.²¹⁸ A more modest proposal was to enhance information sharing between insurers by strengthening the relevant provisions under the Act.²¹⁹

²¹³ “As a direct result of the earthquakes, there has been a disturbance to the physical integrity of the land, reducing it in volume and leaving the body of the land in a changed physical state. This changed physical state has resulted in the land being more vulnerable to flooding, thereby adversely affecting its use and amenity. The primary use of residential land is as a platform for building. Land that is materially more prone to flooding is plainly less suitable for this purpose and is less habitable. The criteria for physical loss or damage are satisfied. We conclude that Increased Flooding Vulnerability constitutes natural disaster damage to insured residential land for the purposes of the Act.” Above n 63, at [79]

²¹⁴ Above n 55, at 15.4.5. *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [73].

²¹⁵ *Earthquake Commission v Insurance Council of New Zealand*, above n 63, at [95]-[96].

²¹⁶ at [114].

²¹⁷ *Earthquake Commission Review of EQC’s Catastrophic Response Operational Capability* (May 2009).

²¹⁸ Above n 8, at 37. *Earthquake Commission Act*, sch 3 cl 7(5).

²¹⁹ At 39.

Differentiated premiums

Adopting differentiated risk premiums has been considered by The Treasury. It was noted that it is technically possible to set differentiated premiums by regulation,²²⁰ and that the level of differentiation could range in specificity – from specifying districts that have been more prone to a given risk, all the way to identifying specific houses subject to specific hazards.²²¹ Imposing a higher premium for higher risk properties would meet some of the future cost of hazards, and could incentivize appropriate mitigation measures ahead of time. While risk differentiation could raise the cost of insurance, leading to people underinsuring or withdrawing from the insurance market, the cost of EQC cover is currently so low that the increase would need to be significant to have this effect.

If people were to withdraw from insuring in response to higher premiums, this could undermine the purpose of the scheme in providing affordable insurance to attain maximum buy-in, and avoid the provision of ad hoc/unbudgeted financial assistance.²²² The risk of widespread underinsurance has become increasingly pressing in the aftermath of the Canterbury earthquake, as insurers have moved from “full replacement” to “sum insured” policies.²²³ While these concerns are valid, it seems sensible for EQC to consider charging differential premiums in a narrow set of circumstances so that the broad coverage provided under the Act is not undermined.

At present EQC has a limited range of tools for reducing cover to properties which are subject to a recurrent hazard (for instance, recurrent flooding due to property being situated close to sea-level).

Inquiry into the scheme and introduction of the Earthquake Commission Amendment Bill

At the time of writing this paper a public inquiry into the scheme was under way.²²⁴ The primary focus of the inquiry is a review of EQC focused on the earthquakes in Canterbury in 2010 and 2011, and the ability of the scheme to respond to such significant natural disasters. The scope does not encompass climate change issues, and therefore this paper has not considered the

²²⁰ Earthquake Commission Act, s 36(1)(c).

²²¹ Treasury, above n 8, at 42.

²²² At 16.

²²³ At 16.

²²⁴ New Zealand Treasury *Briefing by the Treasury to the Finance and Expenditure Committee* (27 June 2018).

inquiry in detail. However, a comprehensive reform bill is expected to follow the inquiry, and the inquiry has already led to the introduction of the Earthquake Commission Amendment Bill on 18 February 2019, with the following changes designed to simplify and speed up the handling of claims and allow greater focus on the scheme's core purpose.²²⁵

- Removal of contents cover (EQC previously provided capped cover of up to \$20,000 for personal property);
- Increase of the monetary building cap from \$100,000 to \$150,000;
- Extension of statutory claim notification deadlines from 30 days to 3 months, or up to two years if the delay does not prejudice EQC's ability to assess the claim;
- Clarification of EQC's authority to share and publish information.

These changes will be fully implemented by July 2020.²²⁶

The 2017 briefing to the incoming Minister explicitly mentions the forecasted increase in frequency and intensity of storm and flood related events.²²⁷ As the inquiry will lead to further legislative reform, investigating changes to EQC's policies to enable it to take a direct role in supporting pre-event resilience within its existing scope could be undertaken alongside the current inquiry.

Direct cover

EQC offers direct cover for properties not covered by private insurance. If private insurance becomes unavailable or more expensive due to sea-level rise impacts, demand for direct EQC cover could increase. This could require EQC to place greater importance on assessing risks and setting premiums for direct cover.

Land damage cover

The full extent of the land damage covered by the statute is unclear. No cases have yet been brought on this topic, suggesting that the monetary amounts involved are relatively low at

²²⁵ Earthquake Commission "EQC Act changes announced" <www.eqc.govt.nz>

²²⁶ Earthquake Commission "EQC welcomes Act changes and gets ready to respond" (13 February 2019) <www.eqc.govt.nz>

²²⁷ Earthquake Commission Amendment Regulations 2017. For the rationale, see Earthquake Commission, above n 1, at 15.

present. High-cost events could include rapid erosion of nearby cliffs, or collapse of retaining walls, including private sea walls.

Any method of settling claims is currently capped at the value of the land lost. In some instances, this will be cheaper than the remedial work that is required. However, as discussed above, land damage cannot be covered through remedial work undertaken on a building.²²⁸ Nor does EQC have the ability to pay additional funds to implement mitigation measures, even when such measures would be cost-saving in the long term. Further, as also discussed above, costs of mitigation required by newer regulatory standards are not covered by EQC.²²⁹ This is because land damage is limited to the value of the land or the indemnity value of the items listed under the definition of residential land. Relocation of buildings is also unlikely to qualify as a remedy for repairing land.

Duty to mitigate

EQC has some latitude to decline claims and to limit or cancel cover for properties at risk of recurrent storm and flood damage. Many of the grounds available for doing so revolve around the claimant failing to take reasonable and practicable measures, or otherwise acting negligently. It is highly likely that this requires claimants to undertake some mitigation measures, but it is unclear how extensive these obligations are. Clarification of this duty could form part of a wider package of climate adaptation measures.

Climate change adaptation opportunities

EQC is currently unable to foster climate adaptation through funding damage mitigation measures. This could be addressed through the passing of regulations. In any case, an opportunity is being lost for EQC to assist with climate-proofing or retreat from at-risk properties that will otherwise be likely to incur the same or similar damage on a recurrent basis.

²²⁸ See above n 202 and accompanying text.

²²⁹ See section on 'Payment', at p 31, above.

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Appendix 1: EQC cover diagram

