INSURANCE - NEW ZEALAND

Supreme Court to consider whether mistake can undo settlement agreement

August 09 2016 | Contributed by Jones & Co

AUTHORS

Sarah Wroe

Caroline Redelinghuys

The Court of Appeal decision in *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd*(1) has been praised as a victory for parties that have a legitimate interest in seeing that release agreements are routinely upheld and enforced. However, the Supreme Court recently gave leave to appeal the decision. One of the approved grounds is the effect of the parties' release agreement, which will again shine a spotlight on the effectiveness of properly drafted settlement agreements.(2)

Facts

Prattley Enterprises Limited owned a commercial building in the heart of Christchurch. The building sustained progressive damage in the Christchurch earthquakes and was eventually demolished. Under a policy with Vero, the building was insured for indemnity value up to NZ$1,605,000 (being the sum insured) on each event causing loss. The policy did not state how indemnity was to be calculated.

Vero and Prattley took the view that as the building had been destroyed, the maximum amount recoverable to indemnify Prattley was the building's pre-loss market value, rather than the depreciated replacement cost.

Prattley and Vero both obtained valuations based on the pre-loss market value of the building with the depreciated replacement cost as a comparator.

A settlement agreement was reached based on the valuation obtained by Prattley, which placed the building's market value at NZ$1,050,000 and its depreciated replacement cost at NZ$1,020,000. The settlement agreement provided for a payment of NZ$1,050,000 plus goods and service tax to settle Prattley's claim for material damage to the building. Payment was made in full and final settlement of present and future claims, known and unknown.

Less than three years later, Prattley sought to claim NZ$8.8 million from Vero. A number of appellate decisions since the settlement supported Prattley's reliance on a different basis for assessing its entitlement to indemnity under the policy. This assessment led to a much higher claim, but to get there the settlement would need to be reopened.

High Court decision

Prattley relied on a number of grounds:

- Vero had breached its obligation of good faith under the policy in relation to the settlement agreement by wrongly advising Prattley that its entitlement under the policy was limited to market value and by not assessing loss on a per-event basis.

- The settlement agreement was not enforceable for lack of consideration.
- The settlement agreement represented Prattley and Vero's mistaken belief about Prattley's entitlement under the policy and as such the Contractual Mistake Act 1977 provided relief.
- Vero had breached the Fair Trading Act as it had misrepresented Prattley's entitlement under the policy.

All four of Prattley's arguments were dismissed.

Court of Appeal decision

The sole point of appeal was whether the release agreement assigned the risk of mistake as to Prattley's entitlement under the policy to Prattley. Under the Contractual Mistakes Act, relief is unavailable where the contract provides for the risk of mistake and assigns that risk to one of the parties.

The Contractual Mistakes Act represents a radical departure from the common law and equitable rules relating to the effect of contractual mistakes.(3) The act aims to strike a balance between the unfairness of holding a party to a contract that they never agreed to and protecting those that have a legitimate interest in having the contract performed.(4) Relief is available in relation to a contract entered into under the influence of a mistake of fact or law if that mistake resulted in a substantially unequal exchange of values at the time of contracting.

Prattley argued that the parties had both been mistaken in believing that the measure of indemnity under the policy was market value and that cover did not reinstate immediately after each earthquake. Prattley argued that the correct measure was replacement with no allowance for depreciation or alternatively with depreciation calculated on an elemental basis that would result in a depreciated replacement cost of around 90% of new building cost.

The court held that no qualifying mistake had been made. The valuations exchanged by the parties indicated that they knew market value was not the only measure of indemnity. The parties had not failed to appreciate that there was an alternative to market value. Rather, they had been mistaken in their opinion that market value was a better measure of indemnity than depreciated replacement cost in the circumstances.

Before the court determined whether the risk of mistake had been assigned to Prattley, it considered the correct approach to the interpretation of a clause which provided for a general release of all claims "known or unknown". The court held that the general rules of interpretation applied. Where the parties objectively seek to exchange valuable consideration for a full and final settlement of all possible claims, the courts will readily give effect to this, recognising that finality facilitates settlements. However, the court emphasised that the enquiry in each case must be whether it was the parties' intention to compromise the particular claim at issue.

The drafting of the release clause in this case left no doubt that the settlement obliged Prattley to take the risk that it was compromising an existing unknown claim arising under the policy, whether by mistake or otherwise.

Prattley relied in part on the appellate decisions which developed the law on how damage under successive earthquakes should be quantified. The Court of Appeal referred to the declaratory theory of common law under which a judicial statement of the law is deemed to have always been correct. Thus, a mistake which only becomes a mistake as a result of future clarification of the law cannot undo the settlement. The parties were taken to have understood that the law on which they relied when settling the claim might be declared wrong with retrospective effect.

The court then considered whether there had been a substantially unequal exchange of values between the parties at the time of contracting. The highest figure available at that time came from Vero's valuation report which placed depreciated replacement costs at NZ$1,400,000. This was compared to the NZ$1,050,000 that was agreed. The court held that this difference could not be taken at face value, as allowance was made for the risk and cost avoided by settlement and that on this basis there had been no substantial inequality of exchange at the date of settlement.

Prattley's entitlement under the policy was addressed in the second half of the judgment. The court held that, based on construction of the policy, the correct measure of indemnity was depreciated replacement cost. However, the court found that as Vero had taken a generous approach to the assessment of market value, Prattley had received a sum that was within the range of depreciated replacement cost valuations. The court upheld the settlement agreement and dismissed Prattley's appeal.

Supreme Court grounds

The approved grounds of appeal to the Supreme Court were:

- the nature and extent of the respondent's liability under the insurance policy; and
- the effect of the release.

Consideration of the first ground of appeal may involve revisiting the High Court's approach that the principle of indemnity must be assessed against the insured's intentions for a building – here the insured decided not to rebuild. The Court of Appeal found that indemnity had to be measured with reference to the replacement cost based on the construction of the policy.

Comment

The object of a release is closure. Money is exchanged in order to discharge liability for present claims and assign the risk of those arising in the future. In *Prattley* the Court of Appeal remained staunch in its commitment to giving effect to the contractual purpose of release agreements. The Supreme Court's view will be nervously awaited by many insurers who no doubt hope that it will echo the Court of Appeal's opinion that finality facilitates settlements. The recent decision to grant leave regarding the effect of the parties' release presents an opportunity to obtain some finality in an area that can be fraught with problems.

For further information on this topic please contact Sarah Wroe or Caroline Redelinghuys at Jones & Co by telephone (+64 9 601 9600) or email (sarah@jonesandco.nz or caroline@jonesandco.nz). The Jones & Co website can be accessed at www.jonesandco.nz.

Endnotes

(1) [2016] NZCA 67, 19 ANZ Insurance cases 62-097.

(2) *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd*, [2016] NZSC 70.

(3) Burrows, Finn and Todd, *Law of Contract in New Zealand* 3rd ed (2007, LexisNexis, Wellington) at 269.

(4) Contracts and Commercial Law Reform Committee, *Report on the Effects of Mistake on Contracts* (1976) at [5].
