The proof of the pudding is in the eating

November 2016

Insureds can have their cake but only if they eat it too

In *Great Lakes Reinsurance (UK) SE v Western Trading Ltd*[1], the Court of Appeal (the CA) has provided clarification as to the circumstances in which an insured is entitled to an indemnity on a reinstatement basis where the insured property is destroyed. The decision affords protection to insurers in circumstances where there is no real prospect that the indemnity will be used for reinstatement purposes.

Background

A property company, Western Trading Ltd (Western Trading), held an informal tenancy of a Grade II listed building known as the Boak. The Boak is owned by Western Trading's only director and principal shareholder, Mr Singh. Western Trading was insured pursuant to a policy with Great Lakes Reinsurance (UK) SE (Great Lakes).

The building was derelict with an agreed value of only £75,000; however it was insured for £2.1m (roughly the amount it would have cost to reinstate). In 2012, it was destroyed by fire, as a result of which the listed status of the premises was revoked. Consequently, the site increased in value due to the development potential. No reinstatement was carried out following the fire.

By the insuring clause in the policy, Great Lakes agreed to indemnify Western Trading against "loss of or damage to the property" and pursuant to an additional Memorandum agreed to provide an indemnity on a reinstatement basis, subject to the provision that nothing would be paid "until the cost of reinstatement shall have actually been incurred".

Great Lakes refused to make any payment on the grounds that the policy was invalid and also that Western Trading had suffered no loss, and could not claim the cost of reinstatement because no reinstatement works had been carried out.

Western Trading issued proceedings claiming £2.1m, alternatively a declaration "that it was entitled to be indemnified by the Policy in respect of the losses it has suffered". The Mercantile Court rejected Great Lakes' arguments on the policy and granted the declaration.

The appeal

Great Lakes accepted the Court's decision that the policy was valid. However, it appealed the correct measure of indemnity on the grounds that there was no relevant loss since the site had actually increased in value due to the revocation of the listed building status.

Any comments or queries?

Catherine Percy
Partner
+44 20 3060 6848
catherine.percy@rpc.co.uk

Alice Wilson
Senior Associate
+44 20 3060 6231
alice.wilson@rpc.co.uk

Steph Rowbottom
Trainee Solicitor
+44 20 3060 6736
stephanie.rowbottom@rpc.co.uk

1. [2016] EWCA Civ 1003.

Therefore, in the absence of any loss of value or any realistic prospect of future loss (ie the cost of reinstatement), the declaration had "nothing to bite on" and was pointless.

Great Lakes also appealed on the grounds that the judge should have held that Mr Singh had no real intention of reinstating and therefore would never actually do so.

The decision

Measure of indemnity

The CA held that where real property is destroyed, the measure of indemnity to which the insured is entitled would depend on (i) the terms of the policy; (ii) the interest of the insured in, or its obligations in respect of, the property; and (iii) the facts of the case including, in particular, the intention of the insured at the time of the loss.

Pursuant to the Memorandum, Western Trading had an "express contractual entitlement" to the reinstatement cost, but only if the work had been "carried out" and the cost had been "actually incurred". Therefore, it was necessary to consider what would have been payable under the policy if the Memorandum had not been incorporated.

Where an insured was the owner of a property, or was obliged to reinstate the property, the indemnity was to be assessed by reference to the value of the property to the insured at the time of the peril and was usually the cost of reinstatement. Consequently, it was unnecessary to decide whether the trial judge was wrong not to determine that there had been no loss of market value on account of the destruction of the property.

The CA therefore held that, if the court was satisfied that Western Trading had the requisite intention to reinstate, it was prima facie entitled to be paid that cost by Great Lakes under the insuring clause before reinstatement begins.

The requisite intention

The true measure of indemnity is "a matter of fact and degree to be decided on the circumstances of each case" per Forbes J in *Reynolds v Phoenix*[2]; and is materially affected by the insured's intentions in relation to the property. The significance of intention begs the question as to (a) what exactly is the requisite degree of intention; and (b) what safeguard, if any, is available to an insurer who pays out the cost of reinstatement to an insured who then finds that he cannot reinstate or, even if he can, in fact, sells the property.

As to (a), the CA was of the opinion that the insured's intention needs to be not only genuine, but also fixed and settled, and there must be a reasonable prospect of him bringing about what he intends to do. As to (b), an insurer who pays out has, in general, no redress if none of the money is used in reinstatement. However, if there is a real possibility that reinstatement might not occur, it is open to the court either to make some form of declaratory relief or alternatively, to postpone assessment of the extent of indemnity (and the payment of it), until such time as it is apparent that reinstatement (i) can and (ii) will go ahead or, at least that there is a reasonable prospect that it will.

The advantage of a declaration was that any dispute about whether what had been done amounted to reinstatement could then be resolved in light of the facts. The CA also observed that "whether or not there has been reinstatement of the property is a different question from whether there has been a change of the use to which the restored building is put", which is helpful guidance in the context of a derelict heritage building.

2. [1978] 2 Lloyd's Rep 440

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Declaratory relief

The CA was therefore satisfied that it was open to the Mercantile Court to make a declaration to the effect that, if Western Trading reinstated the Boak, it would be entitled to an indemnity from Great Lakes. However, it had been wrong to make the declaration with the wording originally put forward by Western Trading as it had not made clear that if reinstatement was carried out, Great Lakes would be required to indemnify Western Trading in respect of that cost up to the limits of the policy. A change in the wording remedied that defect.

Comment

The decision of the CA confirms that an insured cannot take the benefit of reinstatement insurance if he does not in fact intend to use the money for that purpose. Insurers have no redress if they pay out for the purposes of reinstatement to an insured who then does not reinstate. Declaratory relief (or a postponed assessment of the extent of indemnity) therefore affords insurers a level of protection in those circumstances as “the proof of the pudding would be in the eating”.

It does, however, also serve as a reminder that an insured can recover the cost of rebuilding property no matter how uneconomic that may be, as long as that is what he genuinely intends to do.

It is also worth noting that the CA ruled that a reinstatement clause requiring the insured to undertake the reinstatement works “with all reasonable despatch” is not breached whilst insurers deny liability or assert that the insured is not entitled to be compensated on the basis of reinstatement. This is a common sense approach so that insureds are not prejudiced by an insurer’s unlawful refusal to affirm cover.

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Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

12 Marina Boulevard
#38-04 Marina Bay Financial Centre Tower 3
Singapore 018982
T +65 6422 3000

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