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NZ Insurance Market Trends Update

Legal trends and developments impacting claims managers, underwriters, brokers and corporates operating in the New Zealand insurance market.

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W+K INSIGHTS

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Welcome to our 2022 NZ Insurance Market Trends Update

It has been a big and exciting year for the W+K New Zealand team. In February, we welcomed Peter Leman, Caroline Laband and Misha Henaghan and their team of highly regarded insurance lawyers. Six months in, our expanded team is working cohesively together to deliver market-leading expertise and service to our clients.

With 13 partners and over 80 staff, we are proud that W+K is New Zealand's largest insurance law and dispute resolution practice. We have been recognised for our efforts by the market, including being nominated as a Litigation Specialist Firm of the Year at the *NZ Law Awards*, having four senior lawyers recognised as Rising Stars by *NZ Lawyer* and partner Katie Shanks being named as one of the Elite Women by *Insurance Business NZ*.

With our eyes on the future, we are pleased to share the 2022 issue of our *NZ Insurance Market Trends Update*. It explores emerging legal and claims trends impacting insurers, underwriters, brokers and corporates operating in the New Zealand market.

In this edition, we look at new trends in long-standing issues, such as the recent focus in D&O claims on directors' liability when the company is financially distressed, the risks associated with an increased use of structural engineers to strengthen earthquake-prone buildings, and exposures for accountants and lawyers with regard to the bright-line property rule.

We also look at emerging issues, such as condensation claims, claims by workers who are forced to return to the office post-lockdowns, and the potential Income Insurance Scheme.

If you have any queries about any of these updates or would like to know more, please get in touch with our authors or key contacts.

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D&O and Representative Actions

A significant focus in recent D&O claims is on a director's liability when their company is financially distressed. We expect this trend to increase, based on recent decisions and continuing economic pressures.

The Court of Appeal released its much-anticipated judgment in *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] 3 NZLR 99, which carefully stepped through director liability under the Companies Act 1993. The decision made it clear that directors of an insolvent company cannot continue trading, unless they have put in place carefully considered strategies with good prospects of success to restore the company's solvency. If they fail to engage with insolvency in a meaningful way, they will breach the directors' duties owed to the company. Directors also cannot cause their insolvent company to incur specific or general obligations to creditors where there is no reasonable grounds for believing those obligations can be met when due.

There is, however, no liability for the entire deficit where the company would have remained insolvent and been placed into liquidation had the director complied with their duties. There may be more specific liability where new debts are incurred while continuing to trade insolvent. That 'new debt' liability will be the net deficit relevant to creditors while trading insolvent. This will require a fact intensive assessment of the company's net financial position. In *Mainzeal*, the Court of Appeal remitted that assessment back to the High Court, where the liquidators expect a significantly higher award than the original $36 million.

The Supreme Court granted leave to appeal *Mainzeal*, and this was heard in March 2022. Judgment is expected Q4 2022. It will be interesting to see whether the Supreme Court disagrees with the absence of any causative breach for the entire deficit, upholds the liability for new debts, and decides to remit the case back to the High Court.

Following *Mainzeal*, there was a notable judgment against a director for his conduct while his insolvent company continued to trade in *Dempsey Wood Civil Ltd v Gapes* [2021] NZHC 2362. In addition to similar breaches contemplated in *Mainzeal*, and subsequent liability to pay liquidators, the High Court found the director personally liable to a creditor under the Fair Trading Act 1986. The director of a development company told a subcontractor that his company held sufficient funds in a facility for works to pay the subcontractor, where that facility was already ear-marked for other debts. These representations were deemed misleading and a breach of s9 of the FTA (for which intent is irrelevant). The director was ordered to pay sums directly to the creditor (circumventing the usual recovery in liquidation).

We have already seen an increase in claims against directors of failed companies, which include similar allegations of representations breaching the FTA and claims adapting to this 'new debt' or net deficiency approach.

Significant D&O cases

Beyond *Mainzeal*, there are other significant D&O representative actions that are being watched closely.

In the *Intueri Education Group* representative action, the High Court was not prepared to summarily determine claims that the disclosures for the IPO were misleading or deceptive. Notably, the applications were stated to be *"novel; some may even describe it as bold"*. This is a clear signal that complex D&O claims should proceed in the usual way. The *Intueri* representative action continues, with the court due to also consider whether statements made on-market were misleading or deceptive, directors' due diligence defences and reliance on third parties at full trial.

Covid has delayed the progress of the various *CBL Group* actions, with the hearing of the SFO charges against the CEO and CFO adjourned until April 2023. Those charges might have affected issues common to the regulatory actions, creditor claims and representative actions against CBL's directors and officers, including the liabilities of independent non-executive directors. Those civil and regulatory proceedings won't now be heard until 2024. The Court has ordered both representative actions and the regulatory actions be heard together at that time on some liability issues, with evidence of one evidence in the others; an indication the Court is prepared to consider practical steps to ensure common issues are heard and resolved together without inordinate delay. The creditor claims remain separate, with an expected trial date in 2025.

Increased director accountability

December 2021 amendments to the Credit Contract and Consumer Finance Act 2003 were aimed at increasing D&O accountability. The CCCFA now obliges directors and officers of lenders to exercise due diligence to ensure their company complies with obligations under the CCCFA. A failure to do so may result in pecuniary penalties of up to $200,000, for which the director or officer cannot be indemnified by the lender or any D&O insurance.

Directors should also have their preparations underway for the forthcoming climate-related financial disclosure obligations. New obligations under the Financial Markets Conduct Act will, from 2023, require approximately 200 large financial institutions to start making climate-related disclosures. The disclosures will be across four thematic areas against a standard yet to be issued – noting a draft was expected in July 2022.

As with any disclosures required under the FMCA, directors can be personally liable for the company's failures. Given increasing activity by, and resourcing for, the Financial Markets Authority for all FMCA obligations, together with the regulator's increasingly prosecutorial mindset, we expect close scrutiny of D&O obligations with this new regime.

Representative actions

Representative actions remain less extensive in New Zealand than other jurisdictions, although they continue to increase steadily. There are ongoing procedural and substantive issues in various representative actions, for which judgment is needed given the absence of legislative framework and only general guidance from the Supreme Court in *Southern Response*. In addition to the upcoming decision in *CBL Group* on co-ordinating multiple actions, the Courts have also had to discretely consider orders establishing representative defendants and resolve disputes within classes on settlements.

The Law Commission has also released its report, after substantively reviewing representative actions and litigation funding. Our client update can be found here. In brief, the Commission recommends new legislation to govern class actions, particularly on certifying class actions, duties owed by various actors within class actions, enabling common fund orders and fund equalisation orders, and prescribing Court oversight of settlements and funding arrangements. The Commission, interestingly, recommends maintaining the ad-hoc oversight and regulation of litigation funders.

Until any statutory regime is implemented, guidance on representative actions will continue to be ad-hoc.

Michael Cavanaugh
Special Counsel, Auckland

> The *Mainzeal* decision made it clear that directors of an insolvent company cannot continue trading unless they have put in place carefully considered strategies with good prospects of success to restore the company's solvency.

Construction PI (Engineers, Architects, Surveyors, Project Managers)

Seismic design and construction risks

The Canterbury earthquakes of 2010/11 and the more recent Kaikoura earthquakes in 2016 have triggered significant enhancements to New Zealand's building regulatory framework. Managing the earthquake risk of buildings has become paramount in the construction industry. The New Building Standard (NBS) regime is a well-known advancement in this space and is proving to be a catalyst to numerous claims against structural engineers.

The NBS regime

On 1 July 2017, the Building (Earthquake-prone Buildings) Amendment Act 2016 (the Act) introduced the NBS regime to manage risks with earthquake-prone buildings (EPBs). This regime requires buildings to be rated as a percentage of the current earthquake standard for the building. Structural engineers determine the NBS rating of buildings by performing detailed seismic assessments (DSAs). A building is deemed an EPB if it is rated below 34% of NBS.

Owners of EPBs are required by law to perform strengthening (or demolition) works within a set period depending on the risk profile of the building. It is also a common condition in commercial leases and sale agreements for buildings to achieve an agreed NBS rating.

Recent developments

In February 2022, the Ministry of Business, Innovation and Employment reported that, as of 30 June 2021, local councils had identified 4,146 potential EPBs, and determined that 1,736 of them are EPBs.

Structural engineers are increasingly being engaged to prepare designs to strengthen EPBs.

This trend will likely continue for the foreseeable future given more EPBs will likely be found in the coming years, and they will need to be strengthened within the applicable timeframe prescribed by the Act. Health and safety (and moral) obligations could also cause EPBs to be strengthened sooner than required.

Risks for structural engineers and their insurers

Many commercial property owners have engaged structural engineers to carry out DSAs on their portfolios of buildings. Where buildings do not comply with the NBS rating applicable when they were designed and constructed, claims are being made against the structural engineers and peer reviewers involved with the original design and construction (if not time-barred).

These claims are for the cost of upgrading the buildings to make them compliant with the 'standards of the day'. Building owners often take the opportunity to upgrade their buildings to up to 100% of NBS, which can make assessing the proper quantum of the claim against the structural engineer or peer reviewer challenging.

Our experience shows that claims are being made against structural engineers, peer reviewers and their insurers for the following NBS works:

- Designs (both original and remedial) that do not:
  - achieve the prescribed NBS rating applicable when the building was designed and/or constructed
  - comply with the Building Code applicable when the building was designed and/or constructed
- False statements (in the form of Producer Statements) which say that:
  - a building achieves the specified NBS rating
  - strengthening designs:
    - will achieve the prescribed NBS rating
    - comply or will comply with the Building Code
  - strengthening works, as built:
    - achieve the prescribed NBS rating, and
    - comply with the Building Code.

Defective designs

If a structural engineer issues defective original or strengthening designs, they may have breached their contractual and tortious duties to ensure their designs achieve the prescribed NBS rating and comply with the Building Code.

False certifications

Structural engineers could be liable for negligent misstatement and/or misleading and deceptive conduct under the Fair Trading Act 1986 (FTA) if they falsely state the NBS rating and/or Building Code compliance of their work by issuing reports (e.g. DEAs), producer statements, and/or certification documents.

These statements can be relied on by anyone for any reason, but engineers can only be liable to these parties in negligent misstatement if they owed them a duty of care. However, the FTA casts a wider net and only requires the claimant's loss to have been caused by the false statement. The FTA also grants wider powers for relief.

Quantum

The quantum of these claims is commonly in the millions of dollars because seismic strengthening work tends to be invasive and triggers various consequential losses, such as loss of rent.

Mitigating risk

It is important for structural engineers (or any professional) to ensure their contracts effectively exclude or limit liability in contract, tort and, if possible, the FTA. Section 5D of the FTA will allow parties to contract out of the FTA if:

- the contract is in writing
- the services are supplied and acquired 'in trade'
- all parties to the agreement are in trade, and
- it is fair and reasonable for the parties to be bound by the contract.

However, contractual terms cannot exclude or limit tortious liability to third parties, and so even if the structural engineer has no (or limited) contractual liability to its client, there is always a risk that it will be found liable in tort (negligence) to third parties it did not contract with.

Passive fire claims on the rise

The Grenfell Tower tragedy in 2017 triggered widespread concern about the fire safety of buildings, especially in high-rise developments. In response, stakeholders in the New Zealand construction industry have been closely reviewing the fire safety aspects of buildings. The industry is finding that a significant number of buildings are lacking sufficient 'passive' fire protection, with the issue being increasingly litigated. It is proving to be the 'flavour of the decade' in the construction space.

What is passive fire protection?

Building fire safety systems comprise both 'passive' and 'active' fire protections.

The Building Research Association of New Zealand (BRANZ) defines passive fire protection as "the use of construction elements within a building that are designed to prevent or delay the spread of fire and/or smoke". Examples of these construction elements include plasterboard linings, sealants, coatings, collars and wraps. These are distinct from 'active' fire protection systems such as fire alarms and sprinklers which are for detecting, extinguishing and enabling building occupants to escape fire.

Passive fire systems prevent or delay the spread of smoke and fire by:

- separating parts of buildings into 'firecells', and
- comprising 'fire rated' elements that delay the spread of smoke and fire across firecells, such as 'fire separations' and 'fire stopping'.

Passive fire defects

Passive fire elements are defective if they do not comply with the fire safety provisions of the Building Code. That is, if they do not protect people from an unacceptable risk of injury or illness from fire. These defects are mostly found in multi-unit buildings where each tenancy is considered a separate firecell, and where there are more opportunities for defective construction to occur.

Typical passive fire defects include:

- fire separations and structural elements that do not achieve the specified fire rating
- penetrations between firecells that are inadequately fire stopped, and
- fire stopping materials that are incompatible with, or have a lesser fire rating than, the adjacent fire separation.

Litigation on the rise

The New Zealand 'leaky building' crisis first came to widespread public attention in 2002 with the publication of the Hunn Report[1]. In the following decade or so, a multitude of litigation was commenced in the New Zealand courts relating to leaky residential and commercial premises. As expected, the pleaded defects were usually exclusively of a weathertightness nature, such as defective external cladding, roofing or flashings.

However, in more recent times, traditional 'leaky building' claims have evolved into 'mixed defect' claims which include, in particular, passive fire and structural defects. Although these alleged 'non-leaky' defects are often claimed in isolation, it is also common to see them being claimed alongside traditional weathertightness defects.

The scope and cost of fixing passive fire defects will often overlap with the scope and cost of remediating weathertightness defects (many of which will now be time-barred). In this way, passive fire defects can be a 'back door' to recovery in relation to otherwise time-barred weathertightness defects.

That said, passive fire defects are typically much more expensive to fix than weathertightness defects. We are currently seeing and handling defective building litigation regarding multi-unit buildings where the cost to remediate the alleged passive fire defects is in the tens of millions of dollars.

[1] Report of the Overview Group on the Weathertightness of Buildings to the Building Industry Authority

The future

Recent trends show that defective building claims for multi-unit buildings in New Zealand remain constant (and in fact may be increasing). For example, Auckland Council's annual reports for the last four years show that its annual liability for defective buildings has not materially changed:

Provisions (potential liabilities) for weathertightness and other defects:

FY17/18	FY18/19	FY19/20	FY20/21
$319m	$238m	$275m	$308m

Provisions for active claims for defective multi-unit buildings:

FY17/18	FY18/19	FY19/20	FY20/21
$201m	$130m	$183m	$197m

This means that the passive fire risk exposure of construction professionals (especially fire engineers) and their insurers is not going to go away any time soon, with almost all new defective building claims now including a passive fire component.

Widespread failures of PP-R pipe systems

The Austin Hospital in Victoria and the Via6 Apartments in Seattle are recent overseas examples of widespread systemic failures in polypropylene random (PP-R) pipes, which can cause leaks to complex plumbing systems. These failures are prevalent in Australia and the US and are now becoming widespread in New Zealand.

Although PP-R pipes themselves are relatively affordable, plumbing systems as a whole are expensive to replace since they require buildings to be significantly deconstructed, requiring intensive time and labour. This level of remediation is exposing hydraulic engineers, plumbers and their insurers to significant liability risk.

PP-R systems in New Zealand

Plumbing systems originally consisted of copper pipes before PP-R pipes were introduced to New Zealand in the early 2000s. PP-R pipes were marketed as a durable and cheaper alternative to copper and have been widely used in Europe for decades. At the time, it was common to specify PP-R pipes in plumbing systems. A lot of plumbing systems in the 2000s had a mix of PP-R and copper pipes (mixed systems).

Emerging failures

The New Zealand Building Code requires plumbing systems to last for at least 50 years since they are difficult to access or replace. However, hot water systems built in the 2000s and early 2010s are increasingly failing within 8-10 years. The cause of these failures has been heavily investigated, with potential causes including installation, maintenance and operating parameters of the plumbing systems.

In around 2015, it became widely known that mixed systems are not suitable for recirculating potable hot water.

Root cause

Hydraulic and material experts in the industry agree that the root cause of PP-R failures in potable hot water systems is oxidative stress cracking (OSC) – cracking caused by the combination of oxidation *and* mechanical stresses. PP-R pipes are being oxidised by copper present in mixed systems and the chlorine in potable water. Excessive water temperatures and pressures accelerate the oxidation process. Mechanical stresses are also inherently present in recirculatory systems and can be worsened by poor installation and maintenance.

Industry response

Since 2015, the construction industry has been cautious about the use of PP-R pipes. Although they are still commonly used for cold water systems, PP-R pipes are now either banned from use in mixed hot water systems or are only used under the most stringent conditions. Despite being more expensive, stainless steel pipes are increasingly being installed instead of PP-R pipes as a cautionary measure.

Claims

Building owners with recirculatory hot water systems are increasingly either investigating their plumbing or their buildings are already suffering from leaks. Since these systems are expensive to replace, hydraulic and plumbing professionals (and their insurers) are exposed to litigation if, in the last 10 years, they:

- designed, specified, installed or certified the use of mixed systems for recirculating potable hot water, and
- throughout their engagement, failed to advise on the replacement of PP-R pipes.

We are already seeing claims relating to PP-R pipes, and it is becoming more common for PP-R pipes to be included as a separate defect category in multi-party defective building litigation.

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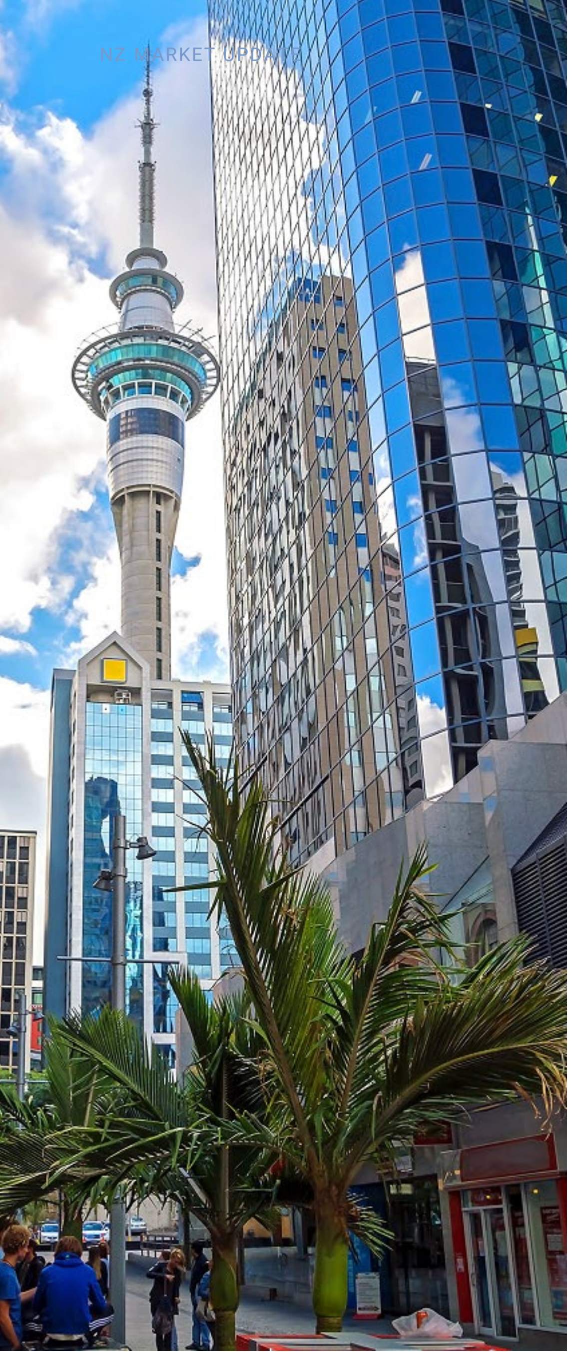

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Financial Services PI (Solicitors, Trustees, Accountants, Tax Agents, Financial Advisers, Brokers)

Solicitors PI – looking in the mirror

The High Court quashed a decision by the National Standards Committee, which found a solicitor acted in a conflict of interest when representing a valuer in disciplinary proceedings on instructions from professional indemnity insurers. This decision is a timely reminder for solicitors advising on professional indemnity to review their client care obligations.

Background

"P" faced disciplinary charges before the Valuers Registration Board (VRB) for giving a "nil market rental valuation". Mr Gallaway from Chapman Tripp (the solicitor) was engaged by P's professional indemnity insurers. The solicitor sent client care terms to the insurer but not the insured. Initially, P tried to get the proceeding stayed on the basis of procedural unfairness. The VRB refused and the solicitor advised judicial review was possible. However, this was not covered by P's policy. The insurer determined coverage and asked the solicitor to review the draft email to P, advising him of the coverage decision.

P did not pursue judicial review at his own cost. The VRB hearing continued and, on receipt of expert evidence, the solicitor advised P and his insurer that the expert evidence was not supportive of P's defence and it was open to the VRB to make a finding against P. P disagreed and wanted to defend the charge but his insurer withdrew funding for a defended hearing. Instead, the insurer advised it would pay for the costs of negotiating a guilty plea and a penalty hearing. The solicitor advised P to take independent legal advice.

P advised he did and was willing to plead guilty although noted he felt pressured to do so by his insurer. Later P made a complaint to the New Zealand Law Society (NZLS) about the solicitor's conduct of his defence. The matter proceeded to a hearing on the papers before the National Standards Committee (NSC). The solicitor engaged Mike Ring QC for an expert opinion on conflict in the context of the retainer between the solicitor, P, and P's insurer. The NSC sought a peer review of that opinion by Peter Watts QC. Both QCs proceeded on the basis the solicitor's clients were both P and the insurer.

NSC decision

The NSC largely dismissed P's complaint and found that the solicitor had acted in a competent and sufficiently timely manner regarding the issues raised by P. However, the NSC made a single finding of unsatisfactory conduct by the solicitor from a failure of client identification, which was not part of P's original complaint. The NSC held that P was the solicitor's only client and that the retainer between the solicitor and the insurer was limited to one of an obligation by the insurer to pay professional fees and a corresponding obligation by the solicitor of "incidental reporting" to the insurer. The NSC held this led to (i) the solicitor giving advice to underwriters contrary to P's interests and putting the insurer's interests first in a conflict of interest; and (ii) P losing an opportunity to defend his reputation.

Quashed on judicial review

The solicitor sought a judicial review of the decision in the High Court on two grounds:

- there was an error of law of by the NSC's conclusion that the solicitor only represented P and not the insurer, and
- a breach of natural justice as the basis for the decision – that the solicitor did not act for the insurer in a dual retainer – was not put to the solicitor for response.

The High Court quashed the finding of unsatisfactory conduct on both grounds.

Regarding client identification – the High Court accepted there was a tripartite relationship between the solicitor, P and his insurer. The High Court said the NSC appeared to have rationalised its conclusion about the contractual arrangements by reference to commercial incentives, which it saw as a consequence of its interpretation of the policy, rather than what the evidence actually showed.

On conflict of interest, the NSC argued that policy interpretation meant that there was a risk of a conflict of interest arising in disciplinary proceedings because the insured wanted to defend his reputation and the insurer would want an admission of liability to reduce costs. This was supported by the fact that fines and costs awards were not covered under the policy.

Rightfully so, the High Court rejected this argument stating that it ignored public policy for not insuring files and costs awards in a disciplinary context. Further the High Court accepted that a conflict could arise in this situation but one could arise in any dual retainer context and it was up to the solicitor to monitor for potential conflicts. Specifically, there was no reason why Rule 6.1[1] would not apply in this context and to any context where a conflict may arise when a solicitor's two clients' interests no longer aligned.

The High Court accepted the NSC made an error of law in (i) its analysis of the contractual arrangements between the solicitor and the insurer; and (ii) in its interpretation of the policy.

The High Court also agreed there was a breach of natural justice by the NSC as the solicitor had no right to respond to the case against him. Of note was that:

- the NSC had a continuing duty to disclose the case against a practitioner
- neither the complaint nor the notice of hearing questioned the nature of the retainer between the solicitor and the insurer – in its correspondence with the solicitor, the NSC had only generally asked for a response to the complaint by reference to *Nicholson v Icepak Cool Stores Limited* [1993] 3 NZLR 475 (HC)[2], and referred to a "client identification issue".

The case was fact-specific and there were several factors in the solicitor's favour:

- he had numerous retainers with the insurer on similar or identical terms – none of which suggested any sort of limited retained as suggested by the NSC
- industry practice was for tripartite relationships or dual retainers
- the usual conflict rules applied, regardless of the disciplinary context
- the solicitor's amendments to the draft declinature email were "minor" and it was accepted the insurer came to its conclusion on indemnity independently of the solicitor and the solicitor advised P (as distinct from the *AB v CD*[3] matter), and
- in this case, the solicitor did advise his client to obtain independent advice when the insurer and insured's interests no longer aligned in line with Rule 6.

The issues for professional indemnity insurers and solicitors

The High Court acknowledged that this case throws up questions of broader general interest and application of how Solicitors Conduct Rules apply to dual retainers. The High Court was unwilling to use Mr Gallaway as a test case and refused to put the matter back to the NSC. It is, however, an example of a Standards Committee using the *Nicholson v Icepak* case against a solicitor in an insurance setting.

For professional indemnity insurers and solicitors, this case creates two key takeaways in the disciplinary context. First, it is important to ensure at the outset that the insured understands the nature of the tripartite relationship with underwriters. This is easily done through a client care letter to the insured (a failing which the solicitor in this case acknowledged but the High Court accepted was not enough, on its own, for a finding of unsatisfactory conduct). Secondly, where an underwriter and an insured's interests no longer align – or if it may appear that way to the insured – it is imperative a solicitor advise the insured to seek independent legal advice and follow Rule 6.1.

Mathew Francis
Partner, Auckland

Alison Cupples
Senior Associate, Auckland

[1] Rule 6.1 of the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 sets out the rules relating to when a solicitor may act for more than one client and the appropriate course of action if those clients' interests no longer align.
[2] The leading authority on a dual retainer between an insured and insurer with the solicitor.
[3] *AB v CD* LCRO 332/2013 where the Standards Committee made a finding of unsatisfactory conduct against a solicitor who acted in a conflict when the insured and insurers' interests did not align and where the practitioner had provided indemnity advice to the insurer.

Auditors

There is a continuing risk of severe disciplinary sanction for auditors who are subject to audit misconduct complaints by clients or the Financial Markets Authority (FMA).

The economic disruption caused by COVID-19 raised critical accounting and auditing issues, with lockdowns and social distancing presenting new challenges for auditors and audit firms. Despite these issues, the FMA made it clear that auditors need to continue adhering to robust standards and that quality audit work was critical.

The FMA's *Audit Quality Report* for 2020/2021 found that 24% of audit files were non-compliant, down from 35% in 2019/2020. The FMA has referred a number of auditors to the New Zealand Institute of Chartered Accountants (NZICA) for potential auditor misconduct. The FMA, which has a monitoring role for NZICA's audit regulatory systems and processes, considered its disciplinary procedures met the minimum standards, but it required clearer and timelier communications about investigations that FMA has a genuine interest in.

Given the scrutiny that the NZICA is under regarding auditor misconduct complaints it is likely it will continue to take a robust approach to disciplinary complaints, which will flow through to tougher sanctions.

Accountants

Cross-border tax and trusts issues

Due to the COVID-19 pandemic, a significant number of New Zealand citizens have returned to (and stayed in) New Zealand. With the borders reopening and the need for skilled labour it is expected that many foreign nationals will look to emigrate to New Zealand. Where those people have foreign assets or trusts or receive foreign income, tax implications and issues will follow. The penalties and use of money interest can present a significant risk to accountants who get it wrong.

There is a myriad of cross-border tax issues, including those associated with controlled foreign companies, foreign investment funds, superannuation and dividends. From a liability perspective there are two broad issues. First, cross-border issues are complicated and accountants who dabble often come unstuck. Second, non-disclosure is a real issue. This can be inadvertent, particularly when dividends have already been taxed in the country of origin. However, non-disclosure can be intentional when client's gamble on no one finding out as they are in another jurisdiction.

With the changes resulting from the Trusts Act 2019 and socio-economic issues many trustees/settlors are looking to make distributions. Accountants involved as trustees or advisers need to be vigilant about the trust's tax classification. This is because the residency of the trust for tax purposes is determined by the residence of the settlor – not the residency of the trustee.

Accountants / lawyers

The bright-line property rule – changes and confusion

Most people are aware of the bright-line property rule. The risk for accountants and lawyers arises from the constant changes to the rule. In 2021, the rule was extended to 10 years, or in some cases five years, from the date the property is acquired. Treasury has recommended that the rule be extended to 20 years.

In 2021 a Supplementary Order paper outlined the Government's proposed changes to the bright-line rule, including proposed rollover relief that will allow technical changes of ownership, including some transfers to family trusts. However, while the Taxation (Annual Rates for 2021–22, GST and Remedial Matters) Act 2022 did extend rollover relief to certain transfers of residential land (on, or after, 1 April 2022 to and from family trusts), it did so only in narrow circumstances where the residential land is transferred to the principal settlor who originally transferred the land to the trust. The Inland Revenue Department (IRD) has indicated it will revisit the application of rollover relief – so we can expect more tinkering soon.

In late 2021 the IRD issued exposure draft PUB00411 Income Tax, which addresses the application of the land sale rules to changes to co-ownership, subdivisions and changes of trustees. The analysis is very detailed and covers the meaning of a 'disposal' to which the bright-line test applies.

Of concern is the wide interpretation of 'disposal'. IRD asserts that where a joint owner of land disposes of a part interest in the land, the bright-line date is reset for the entire land, including the portion of land that is retained.

Its argument is that there is a new registration of title for the entire land, meaning the bright-line clock is reset for the entire land. However, the IRD goes on to say the date the first interest in the land was acquired will determine whether a two-year, five-year or 10-year test applies or whether the rules apply at all.

Financial advisers

Reverse mortgages

Reverse mortgages present a growing risk for financial advisers. A reverse mortgage is a loan where a person borrows an amount of money against the value of their home. The loan is not paid back until the borrower sells the house or passes away. Reverse mortgages are designed for older adults, particularly those who are asset rich and cash poor. The money can be spent on anything, including holidays, cars and health care.

As the interest rates of reverse mortgages tend to be higher they can greatly reduce the value of an estate, which can lead to unhappy beneficiaries who raise capacity issues. The number of reverse mortgages is growing, driven by low levels of superannuation and current retirees having little to no KiwiSaver to draw on. The take up of reverse mortgages is expected to accelerate with many retirees on fixed incomes having to contend with a significant price inflation.

James Dymock
Special Counsel, Auckland

Property PI (REA, Valuers, Building Inspectors, Surveyors)

Building inspectors

Condensation claims

Condensation claims present an emerging risk for pre-purchase inspectors and property and construction professionals. Condensation claims are a relatively new phenomenon, which has resulted from changes in the way houses are constructed combined with changes in the way we are living.

Originally, we constructed houses that might have been cold and poorly insulated but were well ventilated. Now we are building insulated and warm houses, which are often heated and cooled with heat pumps and air-conditioning units. In the summer we shut up our houses and put the air conditioning on. In the winter, we shut up our houses and turn up the heat. This creates condensation that rises up into the roof space where it is damaging ceilings and causing rot by running down into unventilated subfloor areas.

Early indications are that this is more of a South Island issue as greater amounts of condensation concentrate in the roof space over winter there. However, the issue has also been observed in Hamilton and Auckland.

James Dymock
Special Counsel, Auckland

Case highlights how costly marketing material errors can be

The decision in *Routhan (ato Kaniere Family Trust) v PGG Wrightson Real Estate Ltd* [2021] NZHC 3585; BC202164528 is another stark reminder of the potential consequences of errors in marketing material.

On request by the Routhans, an agent (Mr Daly of PGG Wrightson Real Estate Ltd) prepared a proposal with key farm metrics for the express purpose of applying for finance to buy a farm. This proposal recorded the farm's average production at 103,000kg of milk solids for three years from 260 cows and off 105 hectares. If you don't know a lot about farming, this is a 'rockstar' level of production.

But it was too good to be true. As the plaintiffs came to know, the average production was around 98,000kg of milk solids per season and was on the decline. Following the purchase, the plaintiffs worked on upgrading the farm's infrastructure and used a run-off property, but the farm was well behind the production figures estimated (nearly 20% less).

When the plaintiffs were eventually provided with certified production certificates, the plaintiffs realised that the three-year average was actually c. 99,000kg of milk solids per season, but the highest season was reached with a huge amount of extra fertiliser and wintering cows off the property. The actual figures showed a steep decline in production figures across the three years.

The bank eventually lost faith and forced the Routhans to sell both the farm and the run-off property at a loss.

The agent had taken the production information from another agency's brochure. He had also orally asked the owner whether this was correct (noting there was some debate about what was said during that conversation). The High Court ultimately found that Mr Daly never confirmed that prior production levels had been maintained or that milk production for the most recent season was 103,000kg of milk solids.

The plaintiffs alleged that they relied on the statement in their decision to buy the farm. The bank had also appeared to have relied on it. They claimed in negligence (negligent misstatement) and under the Fair Trading Act 1986. The essence of the allegations was that PGG Wrightson Real Estate (PGG) failed to take reasonable care in obtaining the vendor's confirmation and certification of the production levels before providing it to the family trust – that it was negligent in obtaining, verifying and conveying the information about production levels.

The PGG proposal included a standard form disclaimer to the effect that PGG was not responsible for the accuracy of the information supplied by the vendor and that it had not verified that information. PGG ran an unsuccessful defence based on the disclaimer in the proposal document and also alleged contributory negligence and failure to mitigate losses.

Justice Dunningham found, as alleged, PGG breached its duties to take reasonable care and to not make negligent misrepresentations. Specifically, PGG had not confirmed the listing information was correct before the contract was entered into. The Court also found that PGG had been negligent in not following its own procedures.

The scope of damages awarded included the loss of value for both properties (the difference between the additional loss of value of the farm properties suffered as a consequence of the forced sales), as well as the loss of monies invested in capital developments that were not reflected in the sale. A 20% reduction was made to reflect expenditure that had no bearing on production or productivity, and which, in Justice Dunningham's view, exacerbated the financial decline of the farm and contributed to the plaintiffs' losses. The total awarded was $1,697,600.

We understand that this decision is under appeal.

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Associate, Wellington

Employment and EPL trends

COVID-19 related claims

Vaccination and mandates

While vaccination mandates have largely ended and Government restrictions are loosening, new waves and variants may emerge, so employers need to remain alert to developments concerning COVID-19.

Only those who work in the health and disability sector or health-related roles, remain subject to vaccination mandates. Vaccine-related claims remain a risk in these sectors. Underwriters with clients in, or working with, health and disability, still need to consider whether COVID-19 or mandate exclusions should be applied, or how to price cover without such exclusions.

Employers can mandate vaccines themselves if they have a good reason on a health and safety basis. However, the guidance on this has changed. Given widespread community infection levels, mandating vaccination probably is only justified where the risk of contracting and transmitting COVID-19 at work is higher than it is in the community.

Outside of the sectors covered by Government vaccine mandates, WorkSafe considers that few workplaces will be able to justify an employer vaccination requirement for health and safety or public health reasons.

The pace of change in the COVID-19 pandemic is phenomenal compared with typical risks to work health and safety. For this reason, it will not always be easy for employers to get things right. While COVID-19 remains a risk area, vaccine-related claims will continue to decrease significantly in frequency.

Flexible working

One trend that has been accelerated due to COVID-19 restrictions, is the move to working from home and increased workplace flexibility.

Some employers embraced home working because it allowed their businesses to continue during lockdowns. However, many of them now want employees to return to the workplace for reasons including:

- control – some employers think that if they can't see what an employee is doing, they may not be productive
- training and upskilling – some employers think it is easier to train employees "as you go", rather than having to accommodate specific training times
- culture – it can be difficult to maintain a team culture when the team is working remotely, and
- societal – some employers want to help local economies, such as hospitality businesses in struggling town and city centres.

In contrast, many employees have enjoyed flexible working and remain resistant to returning to the workplace full-time.

This disconnect between employers and employees has the potential to cause conflict in the next year and beyond.

It may be difficult for an employer that has survived and thrived with employees working from home to justify requiring full-time attendance at the office.

While there is already the ability to request flexible working for any reason under the ERA 2000 and/or raise a personal grievance for disadvantage, we expect the volume of flexible arrangement-related claims will increase.

Health and safety at work

With green settings imminent, mask mandates are likely to end. Some workers may feel inadequately protected, and uncomfortable working without mask requirements. In the short-term, there could be a rise in claims by employees who are forced to work where they consider it is unsafe for them to do so due to the risk of catching the virus (or someone vulnerable and close to them contracting it).

Although there are no concluded claims relating to this in New Zealand yet, the recent UK case of *Rodgers v Leeds Laser Cutting Limited* [2022] EAT 69 suggests that it will be difficult for employees who claim disadvantage, or are dismissed in such circumstances, to succeed if their employer has complied with Government and WorkSafe guidance.

In rare cases in New Zealand, this type of claim might engage both EPL and statutory liability policies. That is because it is a criminal offence to subject an employee to a detriment for a health and safety issue – not just grounds for an employment claim.

A related issue is the potential for an increase in statutory liability claims for injuries sustained at home under the Health and Safety at Work Act 2015. Employers have been used to limited numbers of workplaces. The rise of flexible working increases this potential liability exponentially. Employers could be liable for physical injuries sustained, as well as mental health issues.

This is challenging as mental health may be difficult to monitor as home and work life occupy the same space.

Long COVID

Most employers seem to be resignedly and pragmatically managing COVID sickness absences, but long COVID may be a possible EPL claims risk area. In the UK, some estimates put the percentage of people living with long COVID between 2-10% of the population. Employers are easing sick staff back into work by making reasonable accommodation, such as working from home, working fewer or different hours, or doing a different role. This is not always feasible and in persistent or severe cases, employers may need to look at termination for medical incapacity. In the US there have been disability discrimination claims by employees alleging long COVID is a disability that their employers have failed to accommodate.

COVID EL or other liability claims for employers

In New Zealand occupationally acquired COVID may be covered by ACC as a work-related disease or infection if there is sufficient evidence the person contracted the virus while in the workplace. Generally Employers' Liability policies do not apply where they duplicate ACC cover.

A recent case in California (*Sees Candies v Ek*, regarding a workers compensation scheme similar to ACC) has highlighted a legal risk for employers who fail to:

- put known, appropriate and necessary safety mitigation measures in place, and
- address the known and foreseeable risk that workers could become infected while working and carry the viral infection home, infecting one or more of their family members.

In *Sees Candies v Ek*, an employee had become infected with COVID-19 at work and subsequently passed it on to her husband, who died. The family instigated a claim against the employer for compensation for the death. The California court found the claim was not barred by the workers compensation scheme, because it was not collateral to or derivative of the employee's injury.

Claims in New Zealand for damages arising directly or indirectly out of personal injury caused by a work-related gradual process, disease, or infection are barred by ACC. On the *Sees Candies* rationale, it is arguable that a family member's death does not arise out of a personal injury to the employee, because the employee is simply a transmission vector. This could open up the possibility of personal injury proceedings.

Insurers should consider the risks posed by these sorts of claims. Most Employers' Liability policies will not cover claims for personal injury suffered by someone other than the employee, but it is sensible for underwriters to review if there is any exposure.

Economic volatility

COVID-19, alongside the war in Ukraine, has resulted in significant global economic volatility. Although employment levels in New Zealand are high and there is a labour shortage, high inflation and supply chain issues may yet result in an economic downturn that puts pressure on businesses. In these circumstances, there is the potential for rising claim volumes due to increasing numbers of restructurings and redundancies.

The impact of any downturn could be mitigated by a rise in contractors/consultants as employees take the opportunity to branch out on their own, as well as the Government's workplace agenda.

Labour Government agenda

The Government is currently proposing several employment-related legislative reforms.

Fair Pay Agreements Bill

The Fair Pay Agreements Bill (Bill) creates a collective bargaining process for fair pay agreements (FPA) to set industry-wide or occupation-wide minimum employment terms.

The Bill aims to prevent a 'race to the bottom', encouraging competition without driving down wages and working conditions. Employees (represented by unions) and employers (represented by employer representative organisations) will bargain for industry-wide or occupational-wide FPAs. An FPA will need to include minimum hours of work, base rates, overtime provisions and penalty rates.

Mediation and the ERA will be available to assist with disputes arising during the process. Once agreed on, an FPA would be vetted by the ERA and then voted on. If voted in it would be ratified and legislated – allowing everyone within its coverage to enforce the terms.

As well as setting industry and /or occupation-wide minimum standards, the Government hopes to improve outcomes and minimise the disadvantages faced by employers who offer fair wages and conditions. We will likely see an increase in competition and more movement within industries as businesses are forced to compete by innovating products and services.

FPAs are likely to have minimal implications for insurers, but insurers should review policy wordings, and consider whether to exclude claims relating to some or all FPA provisions. Breaches of minimum employment standards are likely to be excluded anyway, although insurers may want to check this in the FPA context.

The biggest impact will be on insureds caught by an FPA, even where they haven't been involved in the bargaining. Additionally, contractors are not currently included in the Bill. This creates a risk of employers misclassifying employees as contractors in an aim to avoid minimum standards, which could lead to more employee versus contractor claims.

Income Insurance Scheme

The Government is proposing an Income Insurance Scheme (scheme) that would cover loss due to displacement (i.e. redundancy) and health-related disability. Initial indications were that the scheme could take effect from 2023, however it seems this is being pushed out.

The scheme is a social insurance scheme that would be funded by levies on wages and salaries, with employers and employees contributing 1.39% each. It would cover complete job loss due to displacement, but not due to poor performance, gross misconduct or resignation.

Under the scheme, an employer would be required to give four weeks' notice before displacing the employee and pay them for the first four weeks of unemployment (known as a bridging payment). The scheme then provides a replacement rate of 80% of an employee's prior income (capped at $130.911) for a maximum of six months. Cover for health-related disability provides similar entitlements, where a worker must stop working entirely or experiences a reduction in their capacity to work by at least 50 percent.

If the scheme is implemented, it will hopefully create a clearer process for redundancies. The scheme will discourage employees from challenging the genuineness of a redundancy and provide a financial incentive not to bring a claim. If implemented as currently envisaged, it may decrease the frequency of EPL claims – at least regarding redundancy. We could also see employers massaging other dismissals to fit within the scheme to avoid the stress and financial drain of a personal grievance.

Policies are unlikely to cover the mandatory notice pay and/or bridging payment, so this could be good news for insurers generally.

Overall, there could be a downturn in dismissal personal grievances, but they won't be eliminated. The scheme will not bar personal grievances and a recipient of the scheme could still claim for unjustified dismissal due to unfair process and other pre-dismissal conduct (e.g. bullying and harassment). It may also be possible to claim for lost wages and hurt and humiliation as these are not necessarily precluded or offset by redundancy compensation being paid.

Insurers may need to engage with clients on the value EPL cover provides and appropriate pricing.

Better protections for contractors

The Government is considering better protections for contractors, including:

- Amending the definition of employee to clearly distinguish it from a contractor.
- Formal steps for an employer to work through to determine whether a hire is an employee or contractor.
- Protocols for groups of employees to seek an employment status determination (which could bring risk of class actions).

The Government has already introduced the Screen Industry Workers Bill, retaining the status of workers in the film industry as independent contractors but supporting the industry's desire to establish minimum employment standards.

These signalled changes reflect an increase in workers challenging their employment status and seeking remedies under employment legislation. Some recent examples include:

- Parent caregivers – The Employment Court recently held that parents of disabled adult children who require full-time support are employees of the Ministry of Health (*Fleming v Attorney General* and *Humphreys v Ministry of Health*) and were engaged by the Ministry as homeworkers. In *CSN v Royal District Nursing Service* (a recent COVID-19 vaccine case) the Employment Court found that a parent caregiver remained a homeworker/employee, even after the employer purported to terminate the employment in reliance on the vaccine mandate.
- Builders – Builders are traditionally considered a paradigm example of a contracting relationship. However, the Employment Court has ruled that a builder can be an employee (*Barry v C I Builders Limited*).
- Couriers (*Leota v Parcel Express Ltd*).
- Taxi drivers (*A Labour Inspector v Southern Taxis Ltd*).

There have been some notable exceptions. Most recently, in *Arachchige v Raiser New Zealand Limited*, the Court considered an Uber driver was a contractor because Uber had little control over how and when he worked.

That said, two New Zealand unions are seeking a declaration from the Court that Uber drivers are employees. The unions say the documentation between the parties does not reflect the real nature of the relationship. This case was heard in June 2022, and the decision is hotly awaited.

Despite *Arachchige*, the clear direction of travel of both the current Government and the employment institutions is to protect vulnerable workers, particularly where there is an imbalance in bargaining power. This trend may increase liability for insureds, particularly if challenges to employment status are excluded from EPL policies.

The *Southern Taxis* case has also opened up an area of exposure in D&O liability, with the Court of Appeal finding the directors of Southern Taxis personally liable for unpaid wages and holiday pay. It was irrelevant that the directors genuinely believed the drivers were independent contractors.

Challenges to volunteer status

The trend towards categorising workers as employees (with minimum entitlements) is emerging in various sectors, particularly those that have historically relied on volunteers. Religious organisations, not for profits, other community-focused organisations, and the Government's own agencies (for example the successful parent-caregiver cases *Fleming v Attorney General* and *Humphreys v Ministry of Health*) are being increasingly scrutinised by the media and employment judiciary.

In May 2022, the Employment Court held that claimant ex-members of the religious-commune Gloriavale were employees, not volunteers (*Courage v Attorney General & Ors*).

The claimants were born into the community and had been required to work from as young as six years of age with no remuneration other than food, shelter and a continued place in the community. The Court emphasised that there is no presumption against employment status where religious endeavours are involved. A spiritual purpose is a factor to be assessed alongside others. The Court was also unconvinced that the community's familial ties took the relationships outside of employment.

We expect scrutiny of volunteer roles to continue. While there are touch-stone cases involving secular and religious organisations, New Zealand has yet to see a test-case with a specific cultural overlay. We expect that the Courts would be interested in a volunteer case involving, for example, tikanga Māori.

Tikanga Māori

Tikanga Māori (Māori customary values and practices) is playing an increased role in our legal system generally and will be a focus over the next year and for years to come in the employment sphere. While there is little reference to tikanga Māori in employment-related legislation, and the Employment Court's interaction with it has been limited, there are parallels that can be made between current employment concepts and tikanga Māori.

As the common law moves on from traditional master-servant approach, tikanga is likely to have a greater involvement in employment relations – notably in the areas of mediation, disciplinary investigations, end of employment and procedural fairness.

The limited employment cases involving tikanga Māori have all involved Māori parties or Māori-based governance structures. Nonetheless, they show a willingness to engage in the concept and foreshadow how tikanga, as it becomes more prominent, may apply. Recently, the Supreme Court in *Ellis v R* sought submissions on the application of tikanga Māori, despite it not being raised by either party nor the appellant having any strong connections to Māori culture.

Tikanga is currently being considered by Employment Court in *GF v Comptroller of the New Zealand Customs Service*. The claim pleads the defendant failed to act in line with its own whanonga pono (values) and other tikanga principles relevant to the employment relationship.

It is likely that this case will be the start of a trend towards more integration of tikanga into workplace processes and that organisations that espouse tikanga as their values will be held to this in their culture and practices.

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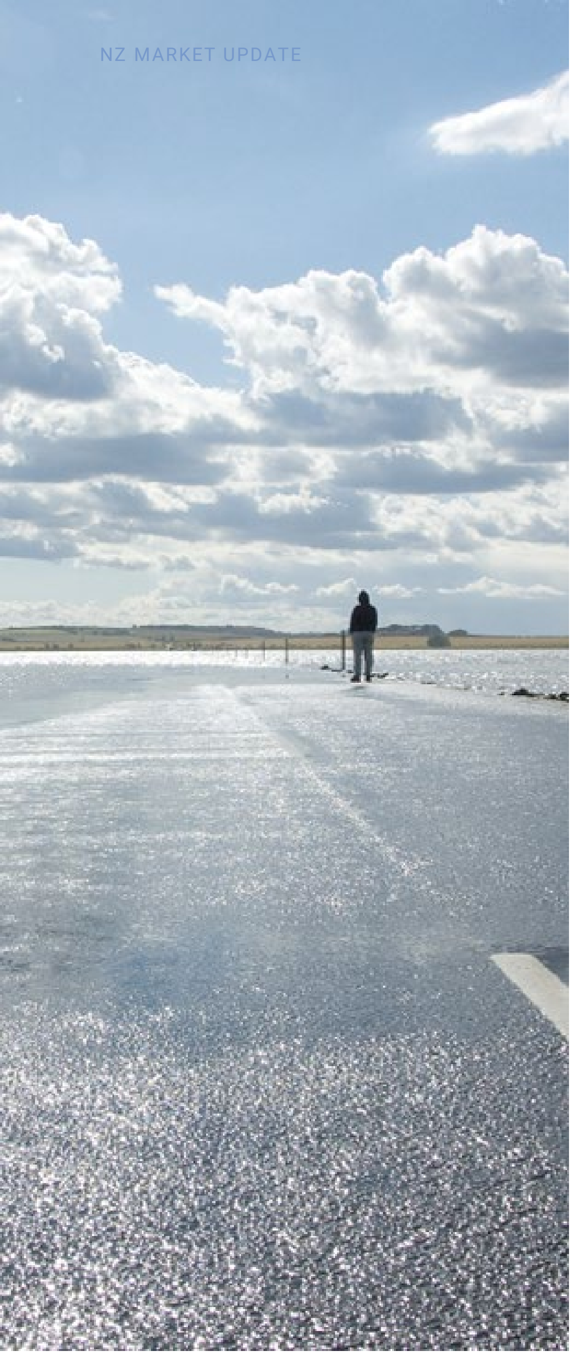
Ella Morrison
Solicitor, Auckland

> Tikanga Māori (Māori customary values and practices) is playing an increased role in our legal system generally and will be a focus over the next year and for years to come in the employment sphere.



Property damage (third party)

Extreme weather events

As insurers are well aware, climate change appears to be increasing the frequency and magnitude of extreme weather events. Last year was Aōtearoa New Zealand's warmest year on record, and seven of the last nine years have been among New Zealand's warmest on record, according to NIWA's annual climate summary. The Insurance Council of New Zealand estimates privately insured damage arising from extreme weather events in 2021 alone at more than $320 million.

In 2021, significant flooding occurred in Canterbury, Auckland, Wellington, the Buller and Tasman Districts, and Marlborough within the space of four months. The Canterbury flooding led to a State of Emergency declaration. Research after the event by the Extreme Weather Real-time Attribution Machine Project found that the extreme rainfall during this event was 10-15% more intense as a result of human influence on the climate system. Floods caused during a weather event between 16-19 July 2021 in Buller, Tasman, Marlborough, Wellington and other parts of the lower North Island required evacuations and resulted in an estimated $140 million in privately insured damage according to the New Zealand Insurance Council.

A significant study in the *Journal of Environmental Management* (conducted by Victoria University of Wellington, NIWA and independent policy research institute Motu) projected the impact of future extreme events on EQC liabilities and estimated a percentage change of between 7%-8% in liabilities for the period 2020 to 2040.

Inevitably, beyond the increase in claims for property damage, this trend will likely involve an uptick in claims for property damage to third parties related to extreme weather events. While extreme weather events are generally seen as an 'act of God' with no blame attributable for loss, there may be a claim against a neighbouring landowner where their acts or omissions have contributed to the loss.

For example, landowners owe a duty in both nuisance and negligence to take reasonable steps to prevent natural occurrences on their land from causing damage to neighbouring properties. Damage caused during a storm as a result of a known blocked culvert on an insured farm may lead to liability for the farmer arising from property damage to their third-party neighbour.

Similarly, unsecured storage of business-related items (such as construction materials) during a high wind event may lead to liability for property damage to a third-party neighbour. Insurers should also consider the possibility of these claims in subrogated recovery actions.

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Partner, Auckland

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"The Insurance Council of New Zealand estimates privately insured damage arising from extreme weather events in 2021 alone at more than $320 million.

Product liability and recall

Reliance key in considering damages under the Fair Trading Act 1986

A current trend in Fair Trading Act claims is a focus on reliance when applying the discretion to award damages. In *Shabor Limited v Graham & Pine Ridge Trustee Company Limited* [2021] NZCA 448, the Court of Appeal confirmed that reliance on a misrepresentation about a farm's carrying capacity meant the difference on purchase price (which was calculated on the basis of carrying capacity) was recoverable as damages.

However, the operating losses incurred after the farm was purchased were not recoverable. Those costs represented the costs incurred to improve the quality of the farm, including carrying capacity. They were not incurred in reliance on the misrepresentation about the farm's carrying capacity. The damages for the difference in purchase price were also reduced for the claimant's failure to take reasonable steps to investigate the carrying capacity claim, as it could have used a due diligence provision in the sale and purchase agreement.

Accordingly, in defending claims for misleading or deceptive conduct and false or misleading representations it is key to carefully consider whether there is a direct connection between the misleading representation or conduct and the damages sought by the plaintiff. In other words, do the damages arise from the plaintiff's reliance on that misleading representation or conduct?

Fair Trading Act amendments

A new set of protections against unfair conduct and unfair business-to-business contract terms under the Fair Trading Act 1986 was introduced in August 2021. These reforms arose out of the government's ongoing focus on unfair commercial practices. Further guidance on the changes is still being developed by the Commerce Commission.

Review of the way in which businesses interact with unsophisticated clients will continue to be a focus of legislative review. This contrasts with the more general legislative policy trend of allowing sophisticated parties the ability to allocate risk between themselves, as demonstrated by the contracting out provisions introduced in 2014.

Businesses or traders will not be able to engage in unconscionable conduct relating to the supply or acquisition of goods or services. While 'unconscionable conduct' is not a defined term, there is a non-exhaustive list of facts that the court can consider when assessing whether a trader's conduct is unconscionable, including the relative bargaining power of the parties, whether the parties were acting in good faith, the particular ability of an individual to protect their interests, the purchaser's understanding of the documents provided by the trader, and whether there was unfair pressure or tactics or other undue influence. Fines of up to $600,000 for a business and $200,000 for an individual are available.

The existing protections against unfair contract terms have been extended to apply to standard form business contracts with an annual value below $250,000, beginning with contracts entered into from 16 August 2022 (and in the case of insurance contracts, from 1 April 2025).

These protections previously applied to standard form consumer contracts only.

However, the Commerce Commission can now also apply to the High Court for a declaration that a term of a standard form small trade contract is unfair, in that it would cause a significant imbalance in the parties' rights and obligations under the contract, is not reasonably necessary to protect the legitimate interests of a party and would cause detriment to a party if it were applied, enforced or relied on. If a party seeks to enforce, apply or rely on a term declared unfair, it will be eligible for a fine of up to $600,000 for a business or $200,000 for an individual.

Where a business has engaged in unconscionable conduct or used an unfair contract term in a standard form small trade contract, the third party will be able to seek redress for any loss or damage under the Fair Trading Act. How these provisions will be interpreted is yet to be seen, but these changes do broaden the scope of Fair Trading Act claims and we expect to see cases brought on a 'but for' basis. For example, a purchaser would not have bought the insured's product and incorporated it into their own, thereby causing damage to it, but for the insured's unconscionable conduct.

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Statutory liability

Regulatory prosecutions

Health and safety prosecutions

There are currently some high-profile health and safety cases. The *White Island/Whakaari* eruption on 19 December 2019 resulted in 13 entities being prosecuted. A few of those prosecutions have been resolved but most are defending the charges, with a four month trial scheduled for July 2023. Also making headlines, Ports of Auckland and its CEO have been charged with reckless offending regarding a fatal accident.

Since 2016, a law change prohibited cover for fines in health and safety prosecutions. Fines of $300,000-$500,000 are now commonplace. That combination has added pressure on defendant insureds to explore defences or alternative negotiated outcomes with regulators, such as enforceable undertakings that avoid a conviction. While the cost of preparation may be covered, enforceable undertakings are more difficult to achieve and require careful assessment upfront.

The regulators have approved fewer enforceable undertakings in the last couple of years. The uninsured expenditure required in enforceable undertaking proposals is firmly in excess of any likely fine, and proposals require increasing sophistication to be approved.

On conviction, reparation/compensation awards (for which there may be cover) continue to climb. In the *Ocean Fisheries* case, the Court awarded $505,000 to 19 family members of three fishing crew who died when their trawler sank. This decision signals that awards will be considered for more surviving relatives, so increases in awards are likely in fatal accident cases (such as *White Island/Whakaari*).

There has been defence resistance to perceived overreach by the regulator in some cases, with the Court clarifying the onerous elements of recklessness to be proved by the prosecutor and dismissing charges (*WorkSafe NZ v Waste Management NZ*). There have also been at least two acquittals this year for health and safety prosecutions (*WorkSafe NZ v Mt Somers Sand Ltd* and *Maritime New Zealand v ISO Limited*).

These shifts have, in turn, impacted defence costs and we expect this to continue.

Environmental prosecutions

A similar shift has also occurred in environmental prosecutions under the Resource Management Act 1991. In those matters, defendants are less inclined to plead guilty, preferring the option of putting a reasonably arguable defence before a jury rather than having the judge decide strict liability defences. That process requires pre-trial decisions on what evidence is to be put to the jury. With COVID-19, the delays in jury trials have also been compounded.

Environmental compliance was not an 'essential service' during COVID-19 lockdowns. However, based on several cases we are involved in, the regulators appear reluctant to make allowance for the challenges presented to business from those circumstances.

There is also upward pressure on these fines (usually insured), although they rarely exceed $100,000.

Commerce Commission prosecutions

There is limited statutory liability cover for Commerce Act and Financial Conducts Authority Act prosecutions (as intent is an element of those offences).

However, there remains cover for strict liability offences particularly under the Fair Trading Act (FTA) and, less commonly, under the Credit Contracts and Consumer Finance Act. The newly introduced changes to the FTA regarding unfair contracts and unconscionable conduct will not apply to statutory liability cover.

The Court of Appeal decision from late 2020 of *Commerce Commission v Steel & Tube* [2020] NZCA 549 remains the leading decision for the starting point for FTA fines and sentencing factors. The decision remains the largest fine handed down under the FTA, although it was reduced to $1.56 million in the Court of Appeal from over $2 million in the High Court. We are now seeing the Commerce Commission more readily prosecute cases resulting from market studies. The *Steel & Tube* prosecution, and prosecutions against others, resulted from wider investigation into structural steel mesh suppliers. There are currently building supplies and supermarket studies taking place. We have seen strict liability prosecutions arising from this with possibly more to come.

Other prosecutions

Across the board, there is a lot of regulator activity in terms of investigations and prosecutions, which we cannot see slowing down any time soon. This includes Ministry of Primary Industries investigations under the Food Act, Financial Markets Authority activity, and other investigations by regulatory bodies, such as Maritime New Zealand.

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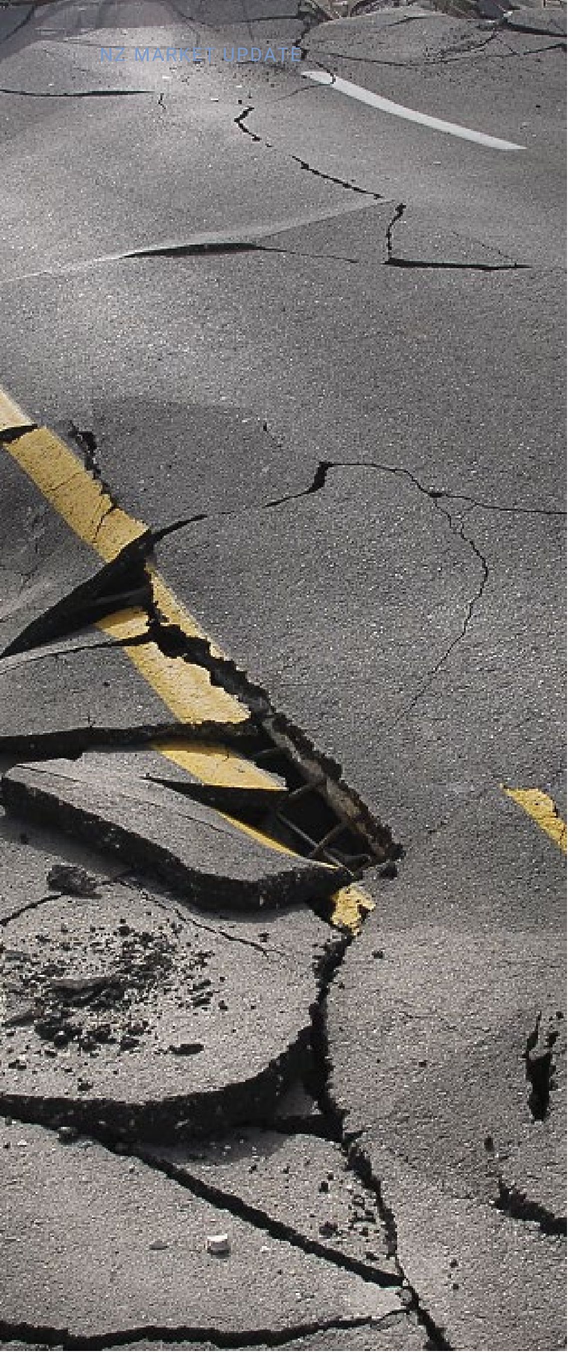

Property (MDBI/Coverage)

A whole lotta shaking going on – The Natural Hazards Insurance Bill

The Earthquake Commission is in for a shakeup. The Natural Hazards Insurance Bill will have the Commission continue as a Crown entity with a new name – Toka Tū Ake – Natural Hazards Commission. This Bill, which seeks to incorporate the lessons learned from the Canterbury and Kaikoura earthquakes, has the primary objective of reducing "the impact of natural hazards on people, property and the community". This is certainly more than a rebrand, given both the scope and the limits of cover are undergoing changes. As previously foreshadowed, the claim cap has been increased to $300,000 + GST.

Alignment with private insurance

There are many similarities between the framing of the Bill and current contracts of insurance. For example, the Bill sets out far more clearly what is and is not covered, as well as when and for what reasons a claim may be declined. While this approach adds to the length of the Bill, it requires far less interpretation than its predecessor. Additionally, as with other insurers, there is the requirement that the new Commission be part of an approved dispute resolution scheme. These changes reflect the greater role the new Commission will have in the New Zealand insurance market and the desire to make the process easier for insureds.

Delegation of claims handling

Section 127 allows the Commission to delegate a majority of the claims handling authority, including the authority to lodge, assess and accept or decline claims. This creates a statutory basis for the arrangements between private insurers and the EQC, which were put in place after the Kaikoura earthquake. It appears the intent is for much of the claim process to be handled by private insurers, with input from the new Commission as and when required. It will be crucial that claims handlers receive adequate training on the new legislation before managing claims on behalf of the Commission.

What is a dwelling?

During the First Reading in Parliament concerns were raised about the Bill's definition of dwelling. Under this Bill a building would not be a dwelling if, for example, it lacked cooking, washing or bathing facilities. One of the concerns involves rural properties, many of which do not have all of these facilities located within one building. Additionally, the Bill extends cover to vehicles (including a motor vehicle, trailer, boat or aircraft) where they contain the facilities required to meet the definition of a dwelling.

While this may initially appear to extend cover to 'tiny homes', the Bill requires the vehicle to be immovable. That means any tiny homes built on movable platforms, which are designed to escape consenting requirements, will not be covered.

Finally, the Bill lacks clarity on whether each unit in a rest home would be considered a dwelling or if the entire building (containing a number of units, which are often not self-contained) would be considered a single dwelling – the difference here is significant in terms of potential exposure for insurers.

What next?

Submissions have now closed and the Bill is currently in Select Committee with its report due at the end of September. Although initial indications were that the new provisions would commence in December 2023, many insurers consider they need more time to implement the various changes introduced by the Bill. These include updating policy wordings and pricing and considering their involvement in the delegated claims handling processes.

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Healthcare and life sciences

Rise in consumer complaints

New Zealand continues to see a steady increase in the number of consumer complaints within the health sector and adjacent industries, such as dentistry and mental health services. For example, during the 2020/21 year, the Health and Disability Commissioner experienced a 14% increase in complaints and 130% increase in the number of cases referred for investigation.

One potential cause of this increase is that some new services, which do not fit the confines of traditional health care, find it hard to manage patient expectations when the type of care and health outcomes they provide differ from what the patient would typically receive. Patient expectations can also be influenced by social media, the internet and other non-regulated sources of health information. To manage this disconnect, health professionals should focus on their patient communications and how they can best assist them to make informed health care decisions. Health providers can also pre-empt criticisms about their standard of care by ensuring practice standards and guidelines are up-to-date and by regularly training staff.

The overall increase in consumer complaints received by regulatory authorities also means that delays are likely for investigations and determinations. Those on the receiving end of complaints should carefully navigate the complaints process, including by ensuring consistent record keeping and developing an internal complaints protocol.

For many health professionals, facing a consumer complaint about the standard of care they provided can be a distressing experience. Care generally involves multiple professionals (and potentially multiple providers), so the circumstances of the complaint can be complex and lead to difficult dynamics between employers and employees. There has also been an increase in consumers pursuing complaints beyond the disciplinary processes offered by regulatory bodies, such as the Health and Disability Commissioner, Privacy Commissioner and other professional bodies.

These regulatory bodies do not have the power to award compensation to the consumer, and so there can be a financial incentive for consumers to bring claims in the Human Rights Review Tribunal (which can award compensatory damages up to $350,000) or issue civil proceedings against health professionals. As the ACC scheme limits claims for compensation for treatment injury, the proceedings that can be brought against health providers often involve complex duty of care issues, overlapping jurisdictions, and various causes of action under different legislation (e.g. Privacy Act and Bill of Rights Act).

COVID-19 update

The life science industry is continuously evolving, and the pandemic has illuminated the importance of innovation in this sector. In New Zealand, the Health Research Council and Ministry of Health has funded several studies and clinical trials into potential treatments to help combat COVID-19 and prepare New Zealand for future infectious diseases.

Stakeholders are investing in, and implementing, digital health technologies and health data management to strengthen health services and systems and ensure accessibility, sustainability and resiliency against disruption.

Life science companies should be prepared for shifting regulatory requirements and evolving liability risks as society and government's focus shift from rapid response to long-term sustainable health solutions in an endemic environment.

The COVID-19 pandemic has also put significant pressure on health practitioners. The Health and Disability Commissioner has been closely monitoring trends across complaints involving COVID-19-related issues. The Commissioner noted in a recent report that, for the first time, lack of access to services was the most common primary issue that complaints were made about.

Indemnifiers have also been faced with a broad range of disciplinary issues arising from the interface between the expectations of professional regulators and personal beliefs about freedom of expression and vaccination against COVID-19.

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Cyber and technology

Privacy Act 2020 18 months on

The Privacy Act 2020 has now been in force for 18 months. In its first full year, the Office of the Privacy Commission (OPC) reported it received four times the number of privacy breach notifications (750 between 1/12/2020 and 30/11/2021) compared to the previous year. The majority of these were the result of human error (62%), with malicious attacks (25%), and information theft (7.5%) being the next two common reasons[1].

The last 12 months has also seen the OPC shift its approach towards enforcement and response to privacy breach notifications. In June 2021, the OPC issued a blog post warning organisations to learn from privacy breaches, and that falling victim to successful similar breaches would attract regulatory scrutiny. The OPC also set out its expectation that notifiable breaches be notified within 72 hours. This was reiterated in the subsequent privacy breach guidelines issued by the OPC[2].

The OPC's own response to breaches has started to reflect these requirements. In our experience, notifications outside the 72 hours window have been met with correspondence noting that the OPC could bring a prosecution under the Act and requesting that the agency in question implement a privacy breach response plan to prevent delayed notification in the future. We expect the OPC's more formal regulatory enforcement will only be a matter of time.

[1] https://www.privacy.org.nz/assets/New-order/Resources-/Publications/Insights-reports/December-2021-Insights-Report.pdf
[2] https://www.privacy.org.nz/assets/New-order/Your-responsibilities/Privacy-breaches/Privacy-breach-guidelines-OPC-July-2021.pdf

Russian Sanctions Act 2020

Following the truly terrible recent events in the Ukraine, the New Zealand Government has joined much of the international community in issuing sanctions against various individuals and entities associated with the invasion. This is a novel step given New Zealand has not previously operated an autonomous regime distinct from those handed down by the UN Security Council.

The Russia Sanctions Act 2022 introduces an autonomous sanctions regime to manage New Zealand's response to the Russian invasion of Ukraine. The Act empowers the government to issue sanctions over people and organisations that are involved in the Russian invasion of Ukraine and well-connected with the Russian Government. The sanctions have banned aircraft and ships owed by the Governments of Russia and Belarus, and the movement of money, assets and goods by a range of individuals and groups into and out of New Zealand.

To date the sanctions have targeted Russian oligarchs, government officials and groups involved in the invasion of Ukraine. It is clear, however, that the Russia Sanctions Act 2022 is also intended to facilitate sanctions against cybercrime groups. The preamble to the bill includes specific reference to cybercrime groups, and the sole example in the definition of sanctionable 'assets' is cryptocurrency.

The Russia Sanctions Act 2022 adds yet another consideration for insureds and insurers when responding to ransomware claims. While the sanctions imposed under the Act to date largely mirror those seen in other jurisdictions, victims should ensure they take legal advice and conduct thorough due diligence before making a ransom payment.

War exclusions – model clauses, *Merck*, *Mondelez*

Quite distinct from the events in the Ukraine, war exclusions in cyber insurance policies have had some attention over the last 12 months. Cyberwar has, notoriously, been a difficult concept to define – particularly in an age with hacking groups being widespread and not attributable to a specific state or country. War exclusions are a similarly thorny problem in the cyber insurance context.

This issue has been addressed in a recent decision of the Superior Court of New Jersey. In the decision of *Merck and International Indemnity v ACE* the court was asked to consider the application of a war exclusion clause in an All-Risks policy to the 2017 Not Petya attack. Merck had fallen victim to the attack, resulting in damages in the sum of USD1.4bn. The Court found that the exclusion should only apply to "traditional forms of warfare", which did not extend to cyber warfare. A further case regarding the NotPetya attack, *Mondelez International Inc v Zurich American Insurance*, is currently working its way through the Illinois courts, and should provide further insight into the scope of commonly found war exclusions.

In the interim, the Lloyd's Market Association (LMA) has released four new model war, cyber war, and cyber operations exclusions: LMA 5564, 5565, 5566 and 5567. The operation of these clauses all exclude (to varying degree) loss "happening through or in consequence" of a cyber operation. The new wording issued by the LMA emphasises the importance of ensuring that exclusions are considered with cyber warfare in mind. It also highlights the difficulty of trying to exclude cyber warfare. Attribution, in particular, to a state actor or state sponsorship is extremely difficult, and consensus on attribution is relatively rare.

The Consumer Data Protection Right – the second round of New Zealand's privacy revolution

When the Privacy Act 2020 was passed, the New Zealand Government acknowledged that the legislation being implemented did not reflect cutting-edge privacy or data protection regulation. This was in no small part due to it being based on recommendations contained in a Law Commission report released in 2011. The Hon. Andrew Little, the sponsor of the bill, acknowledged further reform would be necessary to bring New Zealand in line with best practice, citing rights regarding algorithmic transparency, the right to be forgotten, and expanded regulatory powers and fines.

The first step to update New Zealand's privacy framework post the Act is now underway in the form of the Consumer Data Protection Right (the CDPR). The CDPR is a data portability right, which will allow consumers to request certain information be transferred from one entity to another within particular industries. Early indications are that insurance will one of the designated industries.

Primary legislation implementing the CDPR is still taking shape. However, from the documentation provided it appears the obligations on data holders will be relatively wide.

The CDPR is likely to apply to both consumer data (what might usually be considered 'personal information') and 'product data', or information about services provided. It will also specify technical standards for storage and provision of data, including standardised APIs and data formats.

Given the potential requirements and costs involved, we anticipate implementation of the CDPR may have significant implications for the insurance industry and those who are captured by it. The industry should await the proposed draft legislation with interest.

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David Smith
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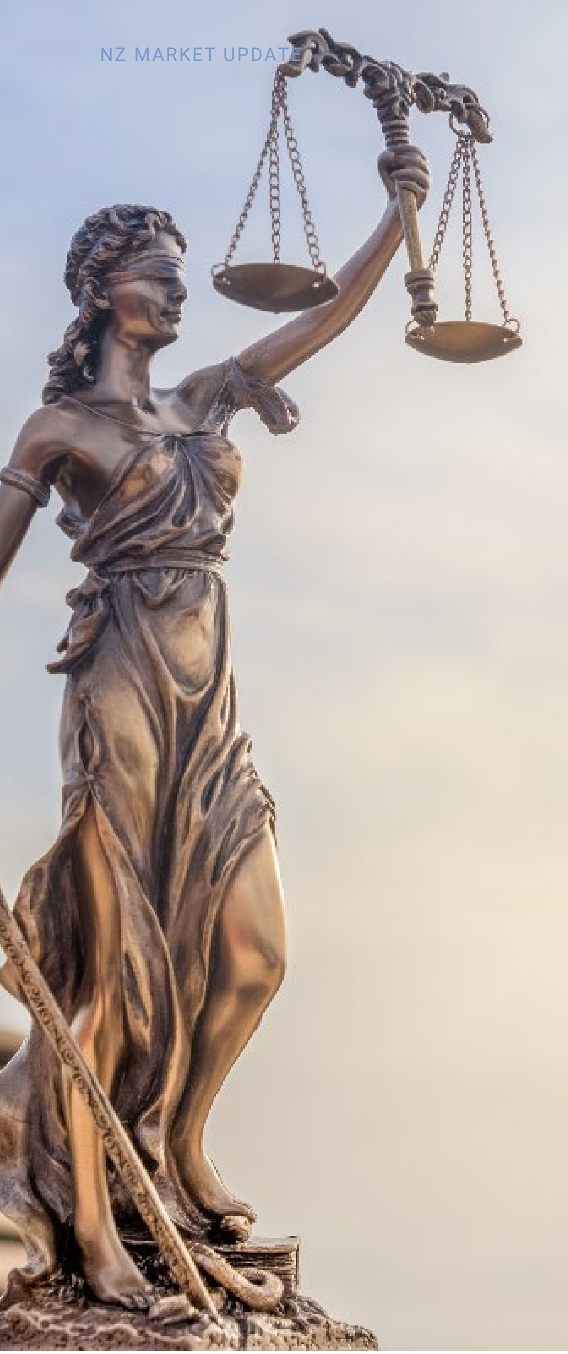
In its first full year, the Office of the Privacy Commission reported it received:

4 TIMES

THE NUMBER OF PRIVACY BREACH NOTIFICATIONS

750 between 1/12/2020 and 30/11/2021



General

Insurance Contracts Bill

New Zealand's legal framework for insurance contracts is being overhauled. The Ministry of Business, Innovation and Employment (MBIE) has issued a draft Insurance Contracts Bill for feedback. The Bill, consolidating the current patchwork of legislation and common law principles, makes some material changes. MBIE has been clear on areas that the Government intends to implement, including good faith, duty of disclosure, no late notice for claims-made policies, no statutory charge and unfair contract terms – among others.

Good faith

Insureds' and insurers' duties of good faith, currently at common law, will be codified as a duty of the 'utmost good faith'. 'Utmost good faith' is not further explained or defined. There is an express provision that the duty of utmost good faith will not override provisions for duties of disclosure.

Duty of disclosure

An insured will either have a negative or positive duty of disclosure before placement, renewal or variation of a policy. The scope of that duty will depend on whether the policy is a consumer policy, being wholly or predominantly for personal, domestic or household purposes. If not, it is a non-consumer policy.

The consumer duty (negative) is to take reasonable care not to make a misrepresentation. The Bill proscribes what is relevant for assessing whether reasonable care was taken: the particular circumstances, the type of insurance, explanatory material provided by the insurer, and the clarity of the insurer communicating the importance of the duty.

Failing to answer questions, or providing incomplete or irrelevant answers, will not be determinative.

The non-consumer duty (positive) is to make a 'fair representation' of the risk. The Bill proscribes what is a fair representation: disclosure of every material circumstance known (actual or constructive) that is substantially correct in fact and with good faith expectation or belief. The representation needs to be clear and accessible, and disclose sufficient information to put a prudent insurer on notice that it needs to make further enquiries of material circumstances.

A circumstance is material if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, its terms. A person is not obliged to disclose circumstances if the insurer knows, ought to know, or is presumed to know the circumstance, or if the insurer waives the information as material.

Where negative or positive duties have been breached, the remedy must be proportional. Explanatory material to the Bill helpfully summarises the proportionate remedies, as shown in the table below.

		Contract	Claims	Premium
1	Qualifying misrepresentations – deliberate or reckless	Avoid the contract	Refuse all claims	Not return any premium
2	Qualifying misrepresentations – not deliberate nor reckless – but without it insurer would not have entered contract on any terms	Avoid the contract	Refuse all claims	Return the premiums
3	Qualifying misrepresentations – not deliberate nor reckless – but insurer would have entered contract on different terms	Contract treated as entered into on altered terms	Reduce the amount paid on the claim by the difference in the premium that would have been charged under the contract or series of contracts	

No late notice for claims-made policies

There will be limited statutory remedy for late notice of claims or circumstances. The substance of s9 Insurance Law Reform Act 1977 (currently ameliorating late notice) will be carried over, except for claims-made policies. The insurer may decline cover where an insured does not notify an insurer of a claim or circumstances within 60 days of a policy period ending, and the insurer notified the insured within 14 days of the policy period ending of the consequences for failing to notify within time. Feedback is expressly only sought on the appropriateness of the timeframes.

No statutory charge

The Bill removes any statutory charge over insurance policies and preclusion of defence costs from eroding limits. Instead, there will be a similar regime to that in New South Wales under which claims can be made directly against the insurer. This requires the insured to first be insolvent, deceased or struck-off and then for the Court to grant leave to proceed. It may no longer be necessary to carry separate liability and costs policies (although there may still be other reasons to do so).

Claims under the affected policy must be paid out in the order in which they are settled, or judgment obtained. This is likely to lead to a race to judgment or settlement under the new regime.

A third party will be able to request specified information from another person, including a policyholder, if they have reasonable cause to consider this would assist their claim. This includes any policy that might be engaged by the claim.

Unfair contract terms

The unfair contract terms regime will extend further to insurance contracts.

The current regime, under the Fair Trading Act 1986, prohibits unfair contract terms in standard form consumer contracts (and shortly extends to small trade contracts). Currently, insurance contracts are specifically exempt. MBIE intends to give the same level of protection as available under other contracts. MBIE is proposing two options and seeking feedback on them.

Option A is based on the Australian model: the regime will not apply to terms describing the specific subject matter insured, or transparently specifying the sum insured and excess.

Option B is more expansive: the regime will not apply to terms identifying the uncertain event or subject matter insured, specifying the sum insured and excess, excluding cover where certain events or circumstances occur or exist.

Other proposals

There are many more changes proposed. Interested parties should review the Bill and MBIE's explanatory material to appreciate the changes and potential impact, and to decide whether to make submissions on the Bill.

Common law material non-disclosure test clarified

The Insurance Contracts Bill proposes significant changes for positive duties of disclosure and, if enacted as drafted, it will usurp the developing common law of material non-disclosure.

The Bill distinguishes a consumer insured, who will only have a negative duty to take reasonable care not to make a misrepresentation, and non-consumers, who will have a positive duty to make a "fair representation of the risk". Remedies are to be proportionate.

As drafted, the Bill will have no retroactive application. Until the Bill passes into law, and for contracts of insurance entered before enactment, the test for material non-disclosure will continue be assessed via the common law.

Currently insureds have a duty to disclose all facts, which are or ought to be known by them, material to the formation of the insurance policy[1]. To avoid a policy for a non-disclosure, an insurer must establish that the undisclosed information was material and would have induced the insurer to extend cover on the terms it did. Inducement is question of fact, and the test for which has not yet been finally settled by the New Zealand Courts.

In *Zurich Insurance PLC v Niramax Group Limited* [2021] EWCA Civ 590 (*Niramax*), the UK Court of Appeal has confirmed the 'efficient cause' test for establishing inducement in cases of non-disclosure.

Under the efficient cause test, an insurer must prove that the non-disclosure was the efficient (effective) cause of entry into the contract on the terms it did. While an insurer does not have to prove it was the sole cause, it must show it was effective.

The efficient cause test differs from the now codified 'but for' test of in the UK's Insurance Law Act 2015. Because of that Act, Niramax likely has limited scope for application in the UK but is expected to have bearing on the development of the common law in New Zealand.

Background to *Zurich Insurance PLC v Niramax Group Limited* [2021] EWCA Civ 590

Niramax is in the business of recycling waste and waste collection. It held a mobile plant policy with Zurich and insured its buildings separately with another insurer, Millennium Insurance.

Millennium extended cover for Niramax's building contents for the 2014/15 policy year, and had requested Niramax undertake several risk mitigation measures, including a fire suppression system. Niramax failed to implement the risk mitigation measures, so Millennium required Niramax to self-insure 35% of any loss. The risk mitigation measures and the self-insure requirement were not disclosed to Zurich before renewal of the Zurich policy.

Zurich had a "commoditised and streamlined" underwriting process, with only three inputs into the calculation of premium: the amount of cover, the nature of the trade, and the claims experience. On renewal, Niramax's 2014/15 policy year premium was calculated by a junior underwriter at Zurich. The underwriter miscategorised the risk of Niramax and calculated (by mistake) a lower premium than should have been applied.

On 4 December 2015, before the plant policy expired, a fire occurred in engine compartment of a machine at Niramax's premises. Niramax sought cover under the plant policy for the destroyed plant. Zurich purported to avoid the plant policy for material non-disclosure. It argued that, had it been aware of the risk mitigation measures and self-insure requirement, it would not have extended cover, or, in the alternative, it would have charged a higher premium.

Zurich argued that, either way, it had been induced to extend cover on the terms it did by the non-disclosure applying the 'but for' test.

Court of Appeal decision

The Court of Appeal, upholding the trial judge's decision, held that the non-disclosed fact must have been an efficient cause of the difference in insurance terms. It found that Zurich's process of setting the premium took no account of risk, aside from the claims experiences input. The non-disclosed information, which related to Niramax's attitude to risk, was irrelevant to the rating of the risk and the quantification of premium. The mistake in premium, which might have been caught had the disclosures been made, was in fact caused by an underwriting error and not the undisclosed information.

Application in New Zealand

The Niramax decision is a welcome development for the law of material non-disclosure, which has otherwise suffered from limited judicial commentary in New Zealand in recent years.

The decision is a salient reminder of the inherently fact-specific inquiry the Courts are faced with in non-disclosure cases. It also clearly sets out the underlying principle that if a non-disclosure has not had a real effect on underwriting judgment, there is no connection between wrongdoing and the terms of insurance so there is no justification for a potential windfall to the insurer (i.e. the collected premium).

The effect of Niramax in the United Kingdom is limited. The 'but for' test is now codified by the Insurance Act 2015. Until New Zealand's Insurance Contracts Bill is enacted, the decision provides useful guidance for insurers in the New Zealand market who are considering avoidance based on a material non-disclosure.

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[1] The remedy of avoidance for material non-disclosure is provided by ss 18 – 20 of the Marine Insurance Act 1908 (which largely follows the UK Marine Insurance Act 1906, now amended by the UK Insurance Law Act 2015).

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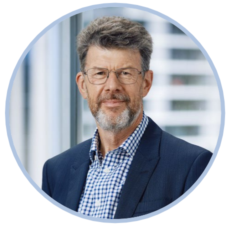

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