



## Reinstatement

### Introduction

Most people are familiar with property policies that give insurers, where property is damaged or destroyed, the option to reinstate or alternatively to make payment of a sum to the insured for the lost or damaged property. However, particularly in respect of real property, it is also possible to obtain cover that removes this right of election from insurers and provides for insurers to pay reinstatement costs.

However, policies commonly provide that the right to reinstatement costs is subject to the insured first incurring the cost of reinstatement. This can present a significant credit risk to an insured if it is faced with an insurer who is refusing to confirm cover.

However, the recent decision in *Western Trading v Great Lakes* has largely resolved this difficulty in the insured's favour.

### The Insured's right to the costs of reinstatement

Historically property damage policies provided cover on the basis that the insurer would indemnify the insured for loss and damage caused to the subject property by an insured peril (e.g. fire or flood).

For example, if a £10m insured property suffers fire damage that reduces its value to £7m, the insured is entitled to claim £3m from the insurer (subject to the policy limits).

However, in more recent years property insurance policies have become available that allow the insured to claim under the policy for the costs of reinstating the insured property.

So, in the above example, if the cost of reinstating the building is £4m the insured will be entitled to claim this sum, even though the loss and damage to the property has been quantified at £3m. Depending on the nature of the property and the insured's operations, reinstatement clauses such as this can be of significant value to an insured.

However, a particularly troublesome feature of such reinstatement clauses is that they are commonly worded on the basis that the insured's right to claim the costs of reinstatement only arises once reinstatement of the property has been carried out. In other words, in our hypothetical example the insured has to first spend £4m of its own money in order to claim £4m from the insurer.

This can be problematic for the insured, especially if the insurer is refusing to confirm cover and the insured is effectively forced to take on the credit risk of reinstatement, hoping that the insurer will later confirm cover or having to take the even greater credit risk of pursuing litigation against the insurer. To all but the largest businesses the cash flow problems this could create may make reinstatement unviable without prior confirmation of cover from the insurer.

### *Western Trading v Great Lakes*

This issue has, to some extent, been resolved by the recent decision in the *Western Trading* case.

In that case Western owned a run-down listed building, which was insured with Great Lakes on a loss and damage and reinstatement basis up to a limit of indemnity of £2,121,800. The reinstatement cover was given on the basis that the insured had to reinstate first, in order to make a claim on the policy for the costs of doing so.

The building was destroyed by fire and Western claimed on its policy. Great Lakes contended that the building's value before the fire was no more than £75,000. Therefore, on a loss and damage basis that would be the most Western could claim under the policy. However, Western claimed for the cost of reinstatement, which (due to the property's listed status) would be substantially more and may exceed the policy limit of £2,121.800.

Great Lakes refused to provide indemnity at all, claiming various policy defences including breach of the duty of good faith and lack of insurable interest, all of which ultimately failed.

However, Great Lakes also contended that the Western should not be entitled to claim the costs of reinstatement as:

- Western had not actually reinstated the building; and
- Western had no intention to reinstate the building in the future.

The Court rejected Great Lakes arguments and held that "*the requirement on the assured to reinstate cannot be read to arise until the insurer has confirmed that he will indemnify*".

The Court went on to note "*That seems obvious where the assured cannot afford to pay for the reinstatement without the benefit of the indemnity which the insurer withholds*". However,

the decision was not restricted to impecunious or small businesses that may not have the funds to pay for reinstatement in the absence of an indemnity.

The Court went on to note that “*the same considerations apply to even a successful business...Even a profitable business will reasonably defer a decision whether or not to reinstate until it knows whether the funding will come from insurers*”.

As Western had not yet reinstated the property it was not awarded damages but was instead awarded a declaration that Great Lakes had to indemnify it for the costs of reinstatement (up to the policy limits) in the event that Western chose to reinstate.

### Insurable Interest

A further interesting feature of the *Western* case was that Great Lakes tried to reject cover on the basis that the insured had no insurable interest in the subject property. The argument failed.

The freehold in the subject property was owned by Western's shareholder, Mr Singh, who had leased the property to Western but no written lease had ever been executed. Western had insured the property in accordance with the terms of the oral lease. This ownership structure is one that is commonly employed by property investors for various commercial and tax reasons (albeit one which is normally documented in written contracts).

In recent years the scope of insurable interest as a defence to claims against insurers has diminished greatly. The Court, noting that it should be slow to find that there was a lack on

insurable interest, followed this trend and held that Western was clearly an integral part of Mr Singh's business and therefore had an insurable interest.

While not unexpected, this decision will provide reassurance to private property investors who employ commonly used corporate ownership structures that in doing so they will not jeopardise their insurance arrangements.

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