# *Sartex Quilts & Textiles Limited v Endurance Corporate Capital Limited [2018] EWHC 1103 (Comm)*

## Reinstating Reinstatement

**Can an insured claim under its property damage policy for the reinstatement cost of a property that had not actually been reinstated and, if so, should the reinstatement cost be discounted for betterment?**

These were the issues that arose under a property insurance policy in *Sartex Quilts & Textiles Limited v Endurance Corporate Capital Limited [2018] EWHC 1103 (Comm)*. The policy covered Sartex Quilts & Textiles Limited ("Sartex") manufacturing and warehouse premises at Crossfield Works in Rochdale. On 25 May 2011 the property was severely damaged and its plant and machinery were destroyed, by a serious fire.

### 1. The Policy

Sartex had taken out property loss and damage insurance with a Lloyd's Syndicate of which Endurance Corporate Capital Limited ("Endurance") was the sole member. The Insuring Clause provided that, subject to the terms, conditions and exclusions of the policy:

> *"Underwriters agree to the extent and in the manner provided herein to indemnify the Insured against loss or destruction of or damage to Property caused by or arising from the Perils …"*

Condition 7 of Section A provided that, subject to the Special Conditions, the basis of calculation of loss would be *"reinstatement of the property lost, destroyed or damaged"*. If that reinstatement comprised rebuilding or replacement, it could be in any manner suitable to the insured's requirements and could also

be at another site. If repair or restitution was involved, it should be to a condition equivalent to or substantially the same as, but not better or more extensive than, its condition when new.

The Special Conditions provided that in order for Condition 7 to apply:

(1) Reinstatement must commence and proceed without unreasonable delay; and

(2) The cost of reinstatement must have been incurred.

If Condition 7 did not apply, the amount payable would be the amount that would have become payable in the absence of that reinstatement condition (i.e by applying the above Insuring Clause).

## 2. The Circumstances

Following the fire, the insured initially intended to reinstate Crossfield Works. However, its attention turned to alternatives, including reinstating the operation in Pakistan (but funds proved not to be available), acquiring other UK premises and rebuilding Crossfield Works, but for an alternative purpose. Eventually, the focus swung back to reinstatement of Crossfield Works, but, by the time of the hearing, no reinstatement cost had been incurred. Endurance was dubious whether there was a real intent to reinstate. On the facts, the Court concluded that had Sartex identified a different development opportunity for Crossfield Works which was likely to be supported by the council and which it considered to be a better use for the site, then it probably would have pursued that, rather than reinstating it as a manufacturing and warehousing facility. In those circumstances, the Court considered it likely that Sartex would have reinstated the manufacturing of the shoddy hard pad lines elsewhere. However, as alternative possibilities at Crossfield Works became more limited, and as Sartex was unable to find appropriate manufacturing premises elsewhere, the Court concluded that reinstating the manufacturing facility at Crossfield Works again became the intended solution.

The parties were in agreement that as reinstatement costs had not been incurred by the trial date, Condition 7 could not apply. Hence, it was common ground that the amount payable under the policy was the amount that would have been payable in the absence of the reinstatement condition, namely pursuant to the Insuring Clause, which provided that insurers would *"indemnify the insured against loss or destruction or damage to Property caused by or arising from"* the fire.

## 3. The appropriateness of the Reinstatement Basis

Sartex argued that the amount had to be ascertained as at the date of the fire, and that, on that basis, its loss was the amount that would enable it to reinstate the buildings, plant and machinery. The effect of this, if correct, would be that the amount payable under the Insuring Clause would still be the reinstatement cost, notwithstanding the inapplicability of the reinstatement provision (Condition 7) itself.

Endurance accepted that the measure of loss under the Insuring Clause could indeed be the cost of reinstatement, but argued that this would only be the case if the insured in fact intended to reinstate the property at the date of loss and on a continuing basis since then up to the date of trial. On Endurance's case, the insured must have had a:

> *"… genuine fixed and settled intention to reinstate what was lost or damaged."*

Endurance submitted that the relevant intention must be to reinstate at Crossfield Works (and not elsewhere), and that what was intended must be a genuine reinstatement, as opposed to the erection of a materially different building. On Endurance's case, the basis of payment under the policy would be the diminution in its value caused by the fire.

Having conducted an analysis of precedent and authorities in which diminution in value was awarded, the Court concluded that the insured's intentions in relation to the property immediately before and at the time of the fire were important factors for it to consider:

> *"It is apparent from the decided cases that the insured's intentions in relation to the property immediately before and at the time of the fire are important factors in determining the value of it to him at that date. If for example the insured had intended to sell, or demolish, the property, then it would likely have a different value to him than if he had intended to use it for manufacturing purposes."*

The Judge continued that if the insured intended to use the property, as opposed to (for example) selling or demolishing it, the appropriate measure of indemnity and the best reflection of the value of the property to him at that time, was likely to be the reinstatement basis.

However, that was not the end of the story. The Court also found that:

*"… Subsequent events (and not just those foreseeable at the time of the fire) may show that such measure would overcompensate the insured, in which case the court at trial is likely to consider another measure of loss more appropriate."*

Applying this test to the facts of the case, the Judge found that by reference to the position of the insured before and at the time of the fire, reinstatement was appropriate. He then moved on to consider events after the fire and up to the date of trial *"to determine overall whether the reinstatement basis of indemnity is the appropriate measure of indemnity … or whether an award on that basis would overcompensate Sartex for its loss".* The Judge concluded that it would not do so and accordingly found that reinstatement cost was to be the basis of the insurance payment.

The Court acknowledged that Sartex may not reinstate the buildings on the site in exactly the same form as they were before the fire, and that whether and to what extent Sartex was to do so may depend on the position in respect of planning consents. He agreed with His Honour Judge Coulson QC in *Tonkin v UK Insurance Limited [2006] EWHC 1120 (TCC)* that it is not necessary for there to be exact reinstatement, but that it is open to the insured to take advantage of the consequences of the fire to make significant changes to what was there before. If he did, however, the insured could not expect insurers to pay for those changes, and doing so could not increase insurers' liability – *"in such cases insurers' liability is to be assessed by a notional reinstatement scheme".*

Accordingly, applying the Insuring Clause to the detailed circumstances of the particular case, the Court found that reinstatement cost was the measure that most fully indemnified Sartex for the loss caused by the fire. In doing so, the Judge therefore rejected Sartex' contention that an insured's intention after and as a result of the loss were only relevant in exceptional cases (such as *Great Lakes Insurance v Western Trading [2016] 2 CLC 498* in which the property had actually increased in value as a result of the fire because it had lost its listed status) and also rejected Endurance's submission that Sartex was required to demonstrate a genuine, fixed and settled intention throughout to reinstate at the same site.

## 4. Betterment

An insured enjoys "betterment" when he receives something that is better than that which he had before the loss. The principle *"is simply that an allowance must be made because the insured is getting something new for something old"* (see *Reynolds v Phoenix Insurance (1978) 2 Lloyd's Rep 440*).

By contrast, in comparable tort and contract claims, it has long been recognised that damages are not reduced to reflect betterment unless the claimant would have been able to mitigate his loss (*Lagden v O'Connor (2004) 1 AC 1067*). In 1970, the Court of Appeal, in *Harbutts Plasticine Limited v Wayne Tank & Pump Company (1970) 1 QB 447*, observed (per Widgery LJ):

> *"It was clear in the present case that it was reasonable for the plaintiff to rebuild their factory, because there is no other way in which they could carry on their business and retain their labour force. The plaintiffs rebuilt their factory to a substantially different design, and if this had involved expenditure beyond the cost of replacing the old, the difference might not have been recoverable, but there is no suggestion of this here. Nor do I accept that the plaintiffs must give credit under the heading of "betterment" for the fact that their new factory is model in design and materials. To do so would be the equivalent of forcing the plaintiffs to invest their money in the modernising of their plant which might be highly inconvenient for them".*

Moreover, regulatory requirements that did not exist when the property was built may prevent its reinstatement into the condition that it was before a loss, thereby forcing the insured to build an improved and more expensive property (when he would not otherwise have had to make those improvements). Cross LJ observed, again in *Harbutts Plasticine*:

> *"… We were told that in fact the planning authorities would not have allowed the factory to be rebuilt on the old lines. Accordingly, in my judgement, the capital sum awarded by the Judge was right".*

Denning LJ summed it up:

> *"They replaced it in the only possible way, without adding any extras. I think they should be allowed the cost of replacement. True it is that they got new for old; but I do not think the wrongdoer can diminish the claim on that account. If they had added extra accommodation or made extra improvements, they would have to give credit. But that is not the case."*

Of course, it is the fact that there is a party claiming damages for a breach of contract or tort against a wrongdoer, which differentiates the *Harbutts Plasticine* type of case from a first party insurance claim. Both are an indemnity against loss, but one is being provided as damages by a wrongdoer and the other by an insurer under a contract of insurance. The law in each case has evolved differently. In insurance, the

principle of making an allowance for betterment, by way of a deduction in the calculation of the insurance payment because the insured is receiving new for old, is well established (as recognised in *Reynolds v Phoenix* above). Nevertheless, it has been questioned recently, perhaps most notably by Christopher Clark LJ in *Great Lakes v Western Trading*:

> *"… The justification for a deduction for betterment is itself open to question …"*

The Judge in Sartex clearly had sympathy with Clark LJ's view, noting:

> *"There is considerable force in the argument that (in the absence of express terms addressing the position) betterment in this area of insurance law should be treated in the same way as in other areas of law. The long established basis for a deduction for betterment in this area of insurance law is that the insured, by reason of receiving something "new for old", has received a benefit by reason of the better condition and quality of the "new", and that an allowance for that benefit should be made so that the indemnity reflects his actual loss, and no more. But in circumstances where the insured has chosen (or has received) the most reasonable and least expensive option available to him, it is a benefit that is in effect an unavoidable consequence of the loss. It is very arguable that in such circumstances making a deduction for betterment deprives the insured of a full indemnity for his loss".*

Nevertheless, the Judge considered himself constrained not to depart from the well established principle and therefore, apparently reluctantly, upheld the application of a deduction for betterment.

However, he continued:

> *"In circumstances where the notional reinstatement cost has been agreed, the onus is on the insurers to identify, and justify, any particular reductions they consider should be made, and they have not done so. On the evidence before me, I do not consider that the notional reduction proposed by Endurance of a third or a quarter (or somewhere between those proportions) is appropriate or warranted".*

Accordingly, without actually going against the established principle of a deduction for betterment, the Court still achieved the result that the Judge clearly favoured in this case – namely making no reduction for betterment – on the basis that the onus is on the insurer to justify that deduction by evidence, which

insurers had not done. It was not good enough simply to apply a notional proportionate deduction for betterment, which had been the approach adopted (as it often is) by the loss adjusters in their reports.

### CPB comment

It is clear from this case that, even if reinstatement works have not been carried out, a Court can award indemnity on the reinstatement basis, if it is the measure which most fully indemnifies an insured for its loss. However, answering the question of when this approach is to be applied may not be easy. One has to establish what the insured has lost as a result of the insured peril. The insured's intentions at the time of loss and immediately afterwards are important factors to be taken into account, and indeed appear to have been the starting point of the Judge's analysis. However, one must also go on to analyse subsequent events right up to the date of trial (not just those that were foreseeable at the date of loss) in considering whether reinstatement would overcompensate the insured, in which case *"the court at trial is likely to consider another measure of loss to be more appropriate".* Whilst that phrase would seem to leave the door open to argument as to what that alternative might be, in all probability it would be the diminution in value of the property (a measure that had been applied in a number of preceding cases).

Accordingly, whilst the test itself may have been clarified, its application to the facts of individual cases could give rise to more, rather than less, differences between insurers and insureds.

However, where reinstatement is found to be the appropriate measure, the tide appears to be turning against the concept of betterment as currently applied in insurance claims and in favour of betterment as applied in ordinary tort/contract claims. It will take a decision of a superior Court to establish this, but on the basis of recent judicial comment, this may be on the horizon. In the meantime, where betterment is applicable, insurers have to produce evidence to justify reductions, rather than simply applying a notional percentage reduction to reflect the fact that the insured has something new to replace something old.

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