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ON THEIR LAST LEGS:

London Engineering Group to Publish Revised LEG Exclusion Clauses

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Charlie Dee, chairman of the London Engineering Group ("LEG"), a professional forum for insurers and reinsurers of engineering and construction risks, announced in late June that the LEG was working to publish revised versions of the LEG exclusion clauses by the end of summer 2026.

The announcement follows a series of recent US judgments which have raised concern as to whether the clauses are ambiguous in respect of what constitutes damage, what is excluded from cover and, in the case of LEG 3, what constitutes 'improvement'.

BACKGROUND

The LEG exclusion clauses (LEG 1, 2 and 3) are model defect exclusion clauses widely incorporated into construction/builder's all risk policies, which respond to damage to property insured. They exclude cover for defects, on the premise that insurers are willing to provide an indemnity for damage to property, they are not prepared to provide an indemnity for defective design, workmanship or materials. The clauses provide progressively wider cover as the clause number ascends with a corresponding increase in premium or excess, with the widest cover being provided by LEG 3.

The LEG clauses were originally published in 1996. Following a revision in 2006, the LEG 3 clause, with the 2006 amendment underlined, states:

"The Insurer(s) shall not be liable for:

All costs rendered necessary by defects of material workmanship design plan or specification and should damage (which for the purposes of this exclusion shall include any patent detrimental change in the physical condition of the Insured Property) occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost incurred to improve the original material workmanship design plan or specification.

For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification."

Despite the wide use of LEG clauses internationally over the last 30 years, there had been no judicial treatment of them. All that changed in 2023 and 2024, with two judgments from the United States.

JUDICIAL TREATMENT IN THE UNITED STATES

In *South Capitol Bridgebuilders v Lexington Insurance Company*[1] ("SCB v Lexington"), South Capitol Bridgebuilders ("SCB") were engaged to build a bridge. Lexington provided a builder's all risk policy, covering "*all risks of direct physical loss of or damage to*" insured property which included the LEG 3 exclusion clause.

During construction, poor vibration caused honeycombing in the concrete forming the bridge abutments and piers, reducing the concrete's load-bearing strength, which required repair. SCB claimed the costs of repair from Lexington; Lexington denied cover, arguing there was no direct physical damage and that LEG 3 operated to exclude the claim for the defective concrete. SCB sued for breach of contract and bad faith.

The sole issue was whether "damage" extended to the cost of fixing the flaws in the concrete that weakened the bridge. The Court held that it did, finding that as 'damage' was undefined in the policy, the ordinary meaning as per Black's Law Dictionary applied: "*loss or injury to person or property*" or "*any bad effect on something*" and found that the concrete's reduced weight-bearing capacity was such an injury or bad effect or 'damage'. Lexington argued the remediation costs were excluded under LEG 3 as these were made necessary by defective workmanship. The Court rejected this, described LEG 3 as "*tortured*" and "*egregiously ambiguous*".

SCB v Lexington was then closely followed in 2024 by *Archer Western-De Moya Joint Venture v Ace American Insurance Company* ("Archer v ACE")[2]. The Archer Western-De Moya Joint Venture was the design and build contractor for a road project in Miami, Florida, which like SCB v Lexington, included a re enforced concrete bridge.

Due to a plant failure, the concrete mix contained too much fly ash which impaired the concrete's strength. A claim was made against ACE for the remedial works on the basis that the concrete would fail to meet the project's specification and had to be repaired. ACE declined cover and sought summary judgment on the basis that "*defective initial construction does not qualify as "direct physical loss or damage," which is required to trigger coverage under the insurance policy.*" While confirming that "*an "all-risk policy" does not extend coverage to "every conceivable loss*", the judge was "*not prepared to accept the insurer's argument that damage to the cement did not involve a physical alteration*" dismissing ACE's application.

In terms of LEG 3, the judge commented that "*the LEG 3 Extension is both a coverage grant and an exclusion*" and referring to SCB v Lexington, said "*The SCB Court then turned to the scope of the exception, which, in language virtually identical to the language in the Policy at issue here, excludes costs incurred to "improve" the original workmanship. The court focused on the practical realities flowing from the use of the term "improve." For example, what, exactly, does it mean to "improve" the original workmanship?*"

The judge concluded that "*the term "improve" is ambiguous and therefore is construed against ACE.*"

Both cases were widely reported and, while arguably neither case creates widescale precedent, they have caused concern in the insurance market, with reports that the LEG clauses have been withdrawn from use by some insurers. While both comment on the language of LEG 3, leaving aside what constitutes 'improvement', the issue in both cases primarily appears to be concerned with determining what constitutes 'damage', as opposed to what is a 'defect'.

THE ENGLISH POSITION

Under English law, what constitutes damage was confirmed in 2024 in *Sky UK Ltd and Mace Ltd v Riverstone Managing Agency Ltd*[3]. The case the concerned timber roofing cassettes that were damaged by water ingress. The Court of Appeal determined that 'damage' was "*any change to the physical nature of tangible property which impaired its value or usefulness to its owner or operator*". Therefore, under English law, for there to be damage, there must be an adverse physical change, which impairs something's value or usefulness. This contrasts with something which is defective or in a defective state where no adverse physical change occurs.

COMMENTARY

All risk polices remain an important risk management tool for construction projects around the globe and parties to those polices require certainty. While the English courts may have come to different conclusions in both US cases discussed, where it may have been arguable that the concrete was defective such that there was no adverse physical change, the 'damage' (pardon the pun) has done such that the LEG suite of clauses require amendment to regain the market's confidence. The re-drafting exercise has no doubt been a complex process given the many interested stakeholders.

Clearer drafting and perhaps a definition of what constitutes damage (rather than defect) might be welcomed, as well as clarification as to what 'improvement' is intended to include if this remains in the revised LEG 3 wording.

We will report again once the revised clauses and guidance are published. In the meantime, it is important to note that existing policies which contain the current LEG (or other) exclusion clauses remain in force.

GET IN TOUCH

Beale & Co have experience advising on the LEG suite of defect exclusion clauses. If you have any questions about the content discussed above, or the potential implications of the existing LEG clauses, or their proposed revisions, please contact Nathan Modell and Nick Kenny.

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[1](D.D.C. Sep 29, 2023), a case before the U.S. District Court for the District of Columbia.

[2]Docket No: CASE NO. 1:22-CV-21160-GOODMAN, a summary judgment application by ACE in the US District Court for the Southern District of Florida

[3][2024] EWCA Civ 1567

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