



AGC
THE CONSTRUCTION
ASSOCIATION

**2024 Surety Bonding and Construction
Risk Management Conference**

Survey of Construction-Insurance Case Law: Recent Court Opinions Impacting the Construction-Risk Field

THIS PAPER WAS WRITTEN IN CONJUNCTION WITH A BREAKOUT
SESSION AT AGC'S 2024 SURETY BONDING AND CONSTRUCTION
MANAGEMENT CONFERENCE

AGC 2024 Surety Bonding and Construction Risk Management Conference

**Paper Title: Survey of Construction-Insurance Case Law: Recent Court
Opinions Impacting the Construction-Risk Field**

Miles C. Holden
Partner and Insurance Recovery Practice Leader

Hanson Bridgett LLP
425 Market Street, 26th Floor
San Francisco, CA 94105
(415) 995-5039
mholden@hansonbridgett.com

**Session Title: Survey of Construction-Insurance Case Law: Recent Court
Opinions Impacting the Construction-Risk Field**

Presented by: Miles C. Holden, Hanson Bridgett LLP

Author/Presenter Biographical Information:

Miles Holden is a partner at Hanson Bridgett LLP's San Francisco office and serves as the firm's Insurance Recovery Practice Group Leader. He advises on a wide variety of insurance matters, and litigates and arbitrates insurance-coverage actions throughout the US. Miles has represented both insurers and insureds, but focuses on advising and advocating for insureds. He obtained his undergraduate degree from Stanford University and his J.D. from Benjamin N. Cardozo School of Law, Yeshiva University. Miles is admitted to practice law in Arizona, California, Florida, New Jersey, New York, and various federal courts.

**Survey of Construction-Insurance Case Law:
Recent Court Opinions Impacting the Construction-Risk Field**

I. Introduction

The construction industry generates an abundance of litigation and, inevitably, some resultant case law. That extends to the construction-risk field, including disputes about and rulings on risk-management arrangements such as those regarding insurance coverage. This is a select summary of recent court opinions from around the United States that might interest and be of use to risk-management professionals who handle insurance-related matters in the construction field.¹

II. Select Case Summaries

A. Builders Risk – U.S. District Court for the District of Columbia Analyzes Whether LEG3 Clause Restricts Coverage

Many builders risk policies contain LEG3 clauses. But the federal district court in Washington, D.C. recently found such a clause ambiguous, thus preventing the insurer from relying on it to restrict coverage.

South Capitol Bridgebuilders v. Lexington Ins. Co., No. 21-cv-1436 (RCL), 2023 WL 6388974 (D.D.C. Sept. 29, 2023), concerned a claim related to the Frederick Douglas Memorial Bridge in Washington, D.C. where "poor vibration of concrete resulted in construction malformations known as 'honeycombing' and 'voiding,' which harmed the structural integrity of the bridge." *South Capitol Bridgebuilders*, 2023 WL 6388974, at *1. This issue caused the contractor to have to incur expenses to "replace sizable portions of the bridge's supportive structures" for which it sought reimbursement under a builders risk policy. *Id.*

The insurer refused to reimburse the contractor, so the contractor filed suit. The contractor moved for partial summary judgment on its claim for breach of contract, and the insurer filed a cross-motion for summary judgment on the contractor's claims for breach of contract and bad faith. Although the parties disagreed on whether there was coverage for the bridge's concrete issues, it was undisputed that the "concrete repair expenses were necessitated by deficiencies in [the contractor's] workmanship" on the bridge's cast-in-place concrete substructure elements (e.g., abutments and V-shaped piers supporting steel arches). *Id.* at *1-3.

¹ All case orders discussed herein were accessed using Westlaw and included this notation: "© 2023 Thomson Reuters. No claim to original U.S. Government Works."

The main body of the policy contained a faulty-workmanship exclusion, but by endorsement, that exclusion was deleted and replaced by a "LEG 3 Defect Extension" ("LEG3 clause") that provided:

This policy shall not pay for loss, damage or expense caused directly or indirectly by any of the following.

* * * * *

(C) 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.

All other terms and conditions of the policy remain the same.

Id. at *2.

The court in *South Capitol Bridgebuilders* granted the contractor's motion and denied the insurer's motion. (The parties agreed that Illinois law governed the policy and, thus, that is the substantive law the court applied. *Id.* at *4.) In so doing, it found that the damage to the bridge fell within the policy's insuring agreement, which insured against "all risks of direct physical loss of or damage to insured property" because "'damage' is properly understood to include the costs of fixing the concrete flaws that weakened the bridge." *Id.* at *5. It then considered whether the insurer had met its burden of demonstrating that an exclusion applied—specifically, the LEG3 clause—and determined that it had not. *Id.* at *9.

The *South Capitol Bridgebuilders* court did not mince its words in stating its view that the LEG3 clause was ambiguous:

The LEG 3 Extension is ambiguous—egregiously so. To understand this, one need only attempt to read it. In just three sentences, Lexington managed to squeeze in a run-on sentence, an undefined term, several mispunctuations, and a scrivener's error. The Extension is internally inconsistent

and bordering incomprehensible. SCB's statement that the Extension is "convoluted" is an understatement.

Id. The court also said that it "rejects Lexington's invitation to ignore the unclear and error-riddled language of the Extension, which Lexington drafted, signed, and now seeks to rely on to deny coverage." *Id.*

The *South Capitol Bridgebuilders* court further explained that while the LEG3 clause purported to exclude replacement or rectification costs incurred to "improve" the original workmanship, what it meant to "improve" the original workmanship was ambiguous. It found that it was not clear from the LEG3 clause whether an excluded "improvement" meant a true upgrade to the original work (e.g., "to replace the defective concrete with solid gold"), or merely patching or replacing defective components. *Id.*, at *10-11 ("After all, if something broken gets fixed, hasn't that thing been improved?").

Ultimately, because the *South Capitol Bridgebuilders* court found that the LEG3 clause was subject to more than one reasonable interpretation, it was ambiguous as to whether it excluded coverage for the bridge's concrete loss. Thus, it held, the LEG3 clause must be construed against the insurer such that it did not exclude coverage. *Id.* at *11.

Although this is a trial-court-level opinion, apparently it is the first in the U.S. analyzing a LEG3 clause. Accordingly, it is getting attention around the country and will likely result in changed policy language in builders risk policies and/or additional litigation. For anyone who deals with builders risk insurance, it will be important to follow further developments on this issue.

B. Commercial General Liability – Illinois Supreme Court Considers Whether Insurer Has a Duty to Defend Additional Insured for Alleged Construction Defects

The duty to defend is a regular area of dispute. And the Illinois Supreme Court recently weighed in on this topic when it found that a subcontractor's CGL insurer could have a duty to defend the project's general contractor/developer, an additional insured, for purported construction defects even in the absence of allegations of damage to "other" property.

In *Acuity v. M/I Homes of Chicago, LLC*, --- N.E.3d ----, 2023 IL 129087, 2023 WL 8266295 (Ill. Nov. 30, 2023), a townhome owners' association filed an underlying lawsuit against the development's contractor/developer for breach of contract and breach of the implied warranty of habitability. The association alleged that the contractor/developer's subcontractors "caused construction defects by using defective materials, conducting faulty workmanship, and failing to comply with applicable building codes," including "leakage and/or uncontrolled

water and/or moisture . . . where it was not intended or expected," thus causing "physical injury to the [t]ownhomes" *Acuity*, 2023 WL 8266295, at *1.

The contractor/developer tendered its defense of the construction-defect action as an additional insured under a CGL policy issued to a subcontractor hired to perform exterior work on the project. *Id.* at *2. The insurer denied coverage and filed a declaratory relief action against the contractor/developer, asserting that the underlying complaint did not allege "property damage" caused by an "occurrence." *Id.* The contractor/developer counterclaimed and the parties filed cross-motions for summary judgment. *Id.* The trial court granted the insurer's motion and denied the contractor/developer's motion, but the appellate court reversed, finding that there was a potential for coverage and that the broad allegations in the underlying litigation, thus, triggered the insurer's duty to defend. *Id.* at *2-3.

The Illinois Supreme Court allowed the insurer's petition for leave to appeal, affirmed the appellate court's reversal of summary judgment for the insurer, and reversed the part of the appellate court's order directing the trial court to enter summary judgment for the contractor/developer. *Id.* at *3, 9. The *Acuity* court then remanded the case to the trial court "[t]o ultimately resolve whether *Acuity* has a duty to defend." *Id.* at *9.

The *Acuity* court first analyzed whether the underlying complaint alleged that there was "property damage," and easily found that "the resulting water damage to the interior of the completed units plainly constitutes physical damage to tangible property." *Id.* at *6. It then analyzed whether the property damage was caused by an "occurrence" (defined as "an accident . . ."), and concluded that "the term 'accident' in the policies at issue reasonably encompasses the unintended and unexpected harm caused by negligent conduct." *Id.* at *7. It thus held that "property damage that results from inadvertent faulty work can be caused by an 'accident' and therefore constitute an 'occurrence' for purposes of the initial grant of coverage under the insuring agreement." *Id.* at *8.

The court also explained that under Illinois law, there is no requirement of an allegation of damage to "other" property for an insurer to have a duty to defend:

Furthermore, we hold that the parties' premise—that there could be no "property damage" caused by an "occurrence" under the policy unless the underlying complaint alleged property damage to something beyond the townhome construction project—is erroneous; it is not grounded in the language of the initial grant of coverage in the insuring agreement. To the extent that prior appellate court cases relied upon considerations outside the scope of the insuring agreement's express language, that analysis, which is not

tied to the language of the policy, should no longer be relied upon.

Yet, recognizing that the allegations here are sufficient to establish an initial grant of coverage is only the first step in determining whether these damages are afforded coverage under a CGL policy and, thus, whether there is a duty to defend. Coverage under the insurance agreement may be precluded by an exclusion.

Id. It went on to leave open the possibility that an exclusion might apply to bar coverage. *Id.* at *8-9.

While the *Acuity* court did not make a final determination on whether the insurer had a defense duty, this opinion reinforces the principle that the duty to defend is broad and clarifies that, under Illinois law, a complaint concerning purported construction defects need not allege damage to "other" property to fall within a CGL policy's insuring agreement.

C. Commercial General Liability – Hawaii Supreme Court Addresses Whether Defending Insurers Have a Right to Reimbursement of Defense Expenses From Their Insureds

In *St. Paul Fire and Marine Ins. Co. v. Bodell Constr. Co.*, --- P.3d ----, No. SCCQ-22-0000658, 2023 WL 7517083 (Haw. Nov. 14, 2023), the Hawaii Supreme Court considered, among other things, the following question certified to it by the U.S. District Court for the District of Hawaii:

Under Hawai'i law, may an insurer seek equitable reimbursement from an insured for defense fees and costs when the applicable insurance policy contains no express provision for such reimbursement, but the insurer agrees to defend the insured subject to a reservation of rights, including reimbursement of defense fees and costs?

Bodell, 2023 WL 7517083, at *1. The court ruled that the answer is "No." *Id.* ("We hold that an insurer may not recover defense costs for defended claims unless the insurance policy contains an express reimbursement provision. A reservation of rights letter will not do").

The *Bodell* court gave three reasons for its answer:

1. "The initial contract governs." The policy at issue lacked language calling for reimbursement of defense expenses to the insurer. And while "[i]nsurers may reserve contractual rights, [they may] not create new ones." *Id.* at *2.

2. "Reimbursement erodes the duty to defend." As the court explained: "Hawaii's duty to defend is determined up front, at the start. Not the end. . . . Reimbursement for defense expenses undercuts the duty to defend." *Id.* at *2-3.
3. "[T]he insured is not unjustly enriched." The court noted that "contracts benefit both sides. Though it owes a duty to defend, the insurer benefits. It retains the premiums. It directs litigation. It runs the case, decision-making-wise." It went on to observe: "If we allowed reimbursement, the unjustly enriched party may very well be the insurer. When the insured pays back defense costs to the insurer, it pays for the insurer to protect itself." *Id.* at *1, 3-4.

Thus, in Hawaii, it seems that insurers must have an express reimbursement provision in their policies to recover defenses expenses from their insureds.

To the extent that insurers question whether they are on stable ground seeking reimbursement of defense expenses from their insureds without an express reimbursement provision under the laws of other states, they might start including such provisions in all of their policies.

III. Conclusion

This sampling of recent case law is a reminder that, notwithstanding the unique details of a particular case, basic principles of insurance law generally require that courts narrowly interpret coverage-limiting clauses and broadly construe liability insurers' defense-related obligations.