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Quakes and Aftershocks: The Impact of US Litigation and Claims Practices on the Global Insurance Community

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Abstract:

The 2023-2024 US LEG 3 decisions sent a shock through the builder's risk marketplace. Many insurers are still struggling with how to define their position going forward. This session brings together an international panel comprised of coverage lawyers from the U.S. and U.K., a global insurance claim leader from Singapore and a Canadian general contractor. The panel will discuss how the US legal and claims landscape made these decisions predictable and inevitable. We'll look at how the decisions have impacted the global marketplace and how that effect rebounds back in the US. Most importantly, the panel will examine what lessons can be learned, both abroad and domestically, to inform better underwriting and better claims resolution.

Learning Objectives:

1. Gain a broader understanding of how the US legal system's focus on policy interpretation differs from other jurisdictions.
2. Be able to spot and discuss potential ambiguities born of differences in legal culture.
3. Better understand differences in claim resolution practices inside and outside the US.
4. Assess potential improvements to their own insurance procurement and claims resolution practices.

Target Audience:

Anyone interested in gaining a broader, global view of construction risk management should attend this session. It will appeal to mid-to senior-level professionals who deal with claims and insurance at contractors, insurance companies, brokerages and law firms. In house counsel, risk managers, underwriters, brokers, claims adjusters and advocates, and coverage counsel should all find value and an opportunity to participate in the discussion. Audience participation will be sought.

Session Format:

Panel discussion (60 minutes) with a moderator guiding conversation across diverse perspectives (law firms, broker, contractor). The panel will incorporate real-world case studies and interactive audience Q&A.

Two years ago, two very significant builder's risk insurance cases were decided which sent shockwaves through the construction insurance world. The first was South Capitol Bridgebuilders v. Lexington Ins. Co. (No. 21-CV-1436-RCL, 2023 WL 6388974 (D.D.C. Sept. 29, 2023) and the second was Archer Western - De Moya Joint Venture v. Ace Am. Ins. Co., 713 F. Supp. 3d 1260, 1264 (S.D. Fla. 2024). These cases answered policy interpretation questions which had been responsible for many disputed claims including the meaning of "direct physical damage", whether property (particularly concrete in both cases) must first be in a "satisfactory state" before it may be deemed to be damaged; what is the difference between defective work and resulting damage; and, whether repairing defective work is an "improvement" and therefore excluded. The courts answered these questions in the context of the policies' coverage grants and in the context of the policies' exclusions for faulty workmanship, which in both cases were forms known as "LEG 3" ("LEG" being a reference to the London Engineering Group, the author of the form). Both decisions were big wins for the policyholders, but they were not without repercussions.

Both courts found the LEG 3 exclusion "egregiously ambiguous." The South Capitol court called the LEG 3 endorsement "inconsistent and bordering incomprehensible". Prior to these decisions, the LEG 3 endorsement had been widely used in the US and around the world for more than 20 years and was considered the "gold standard" of construction defect exclusions, in so far as the LEG 3 form was thought to provide the widest exception compared to the basic exclusion. Virtually overnight, insurers stopped offering the LEG 3 form (and similar LEG 2 form) for US construction risk. While attempts began in London to rewrite the form, in the United States, most insurers reverted to offering "cost of making good" endorsements. While many insurers claimed these "cost of making good" forms were "LEG 3 equivalent", they were not, by a long stretch. "Cost of making good" forms tend to require an "ensuing loss" to trigger coverage – a restriction not found in the LEG forms.

There are lessons to be learned about these two decisions and their repercussions. US courts tend to interpret policies according to the plain meaning of the chosen words. US courts are much less likely to consider intent and industry customs than courts in other countries. US courts are quicker to find ambiguity in language where a plainer way of expression was possible. And when this happens, US courts are more likely to hold the ambiguity against the insurer than against the insured. For example, where the parties argued about the meaning of "damage", the court in South Capitol referred to Black's Law Dictionary to conclude that "damage" includes "any bad effect on something". Similarly, in considering the LEG 3 form's assertion that only the cost to "improve" damaged work is excluded, the Archer Western court concluded that "improve" was ambiguous and therefore construed against the insurer. In both cases, the courts held that "damage" included loss of structural stability occasioned by defective concrete batches in Archer Western and by defective form vibration in South Capitol.

In many ways, the outcomes of these two cases were predictable. Insurers and insureds had been wrestling over the meaning of "direct physical damage" for many years and yet policies offered no clarification. (Interestingly, the "cost of making good" forms in use now also offer no clarification.) The cases serve as a reminder of what can happen when these types of disputes are put to a court to decide. Inevitably, insureds and insurers in coverage disputes view entitlement (or the lack thereof) through the lens of intent and industry custom. Even where a particular issue is hotly debated, a measure of predictability is assumed. With these two decisions, many people were surprised at how much of these policies the courts "burned down" in the process of resolving the disputes at hand.

One lesson may be that commonly debated issues should be addressed, and quickly, at the policy drafting stage and not in the courtroom. When one considers the amount of coverage disputes that have arisen over the years over the meaning of "damage" leading up to these court decisions, one could easily conclude that these decisions were inevitable. Another lesson may rest in not tempting fate in a courtroom where the opportunity for a reasonable settlement may lie. It could be argued that in both cases, the insurers approached court resolution with a measure of overconfidence. (The fact that the Archer Western court, while not bound by the South Capitol court's decision, nonetheless agreed with it and reached the same conclusions speaks volumes to the relative strengths of the arguments both courts faced.)

Finally, we ask the question of whether decisions like these are unique to the US, or whether their like are possible, and perhaps even likely, elsewhere. This is a hard question to answer. We know that may industry experts would say these are uniquely American. But is that just the frank, harsh tone of these decisions, or is it the actual substance? Many other jurisdictions place more significance on intent and custom. Many other jurisdictions have rules and procedures that make courts less accessible. But in the end, these issues seem universal.