

# LEG clauses – the latest thinking

## Construction All Risks Webinar

Welcome to our webinar hosted by David Pliener, Simon Kerry and Louis Zvesper. The session will start at midday.

**This webinar will be recorded.**

Please make sure your microphones are muted and your full name is on display.

Thank you!



**David Pliener**

david.pliener@gatehouselaw.co.uk



**Simon Kerry**

simon.kerry@gatehouselaw.co.uk



**Louis Zvesper**

louis.zvesper@gatehouselaw.co.uk

# 2021 Construction All Risks Webinar Programme

This is the 5<sup>th</sup> of 6 webinars

considering current issues regarding

**Construction All Risks Insurance**

# Construction All Risks Insurance 3<sup>rd</sup> Edn.

Published at a time of significant change in the law.

- The law relating to business interruption cover has been reinterpreted in *FCA v Arch*.
- The law as to who is insured and for what has been clarified in *Gard Marine* and *Haberdashers' Aske*.
- Issues regarding defects exceptions continue to be problematic following the Canadian decision of *Acciona*.
- The law regarding betterment has evaluated in *Sartex*.
- The meaning of damage has been considered in the New Zealand earthquake cases.

# Overview

- Introduction to LEG clauses
- LEG 1 – It's all excluded
- LEG 2 – only excludes the hypothetical cost to remedy defect pre damage
- LEG 3 – only excludes cost incurred to improve



# Introduction to LEG clauses

- Damage vs Defect
- 'DE' clauses
- 'LEG' clauses



# LEG 1

- *“The insurer shall not be liable for Loss or Damage due to defects of material workmanship design plan or specification”*
- Very close wording to ‘DE 1’
- The defect as proximate cause
- Query the dropped hammer



# LEG 2

# Market context

*“With the market hardening and the choice of the second tier defects clause being imposed on insureds...”*

Willis Towers Watson, November 2020

- Issues arising from LEG 2/96 becoming of greater importance
- Differences between LEG 2 and equivalent DE provisions (DE 3/DE 4) more acute



# LEG 2/96

*The Insurer(s) **shall not be liable for***

*All costs **rendered necessary** by defects of material workmanship design plan specification **and** should damage 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 which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.***

# LEG 2/96

*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*

# “shall not be liable for”

- Opening wording is exclusionary...
- ...but read as a whole the clause preserves cover for damage consequent upon a defect.
- *PCL Constructors Canada Inc. v Allianz Global Risks US Insurance Company* [2014] ONSC 7480
- Cover provided is therefore significantly broader than LEG 1, which is an outright exclusion

# LEG 2/96

*The Insurer(s) **shall not be liable for***

*All costs **rendered necessary** by defects of material workmanship design plan specification **and** should damage 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 which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.***

# “and”

- Whole clause must be read together
- Second part of the sentence modifies the first
- Otherwise, LEG 2 would have the same effect as LEG 1

# The cost excluded

*“the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.”*

# “the cost excluded”

1. Calculate cost of rectifying damage
2. Calculate hypothetical of cost of rectifying defect at the moment immediately before damage
3. Deduct 2 from 1

# Comparison with DE3/DE4

- Causal connection
  - LEG 2 – costs “rendered necessary”
  - DE3/4 – property “in defective condition”
  - Underappreciated difference in the market
- *CA Blackwell (Contractors) Ltd [2007] EWCA Civ 1450 at [17]*
  - *“if the capping and sub-formation... were in a defective condition when damaged the exclusion would apply even if the damage had been caused by a bomb falling onto it.”*



# Comparison with DE3/DE4

- Division/subdivision of insured property into defective/not defective
  - DE3/DE4 – all important
  - LEG 2 – of lesser significance
- Greater conceptual clarity a significant advantage of LEG 2



# Application in practice

- Significant variation in potential deduction
- E.g. access costs
  - May be very significant
  - Gas turbine
  - Defect in foundations
- Conversely – single point failure of complex machine
- Cannot generalise as to which more favourable for insured (DE v LEG)

# Acciona

- *Acciona Infrastructure Canada Inc. v Allianz Global Risks US Insurance Company* 2015 BCCA 347
- Canadian authority
- Only reported case on LEG 2
- Settled before final appeal (of doubtful authority)

# Fly forms



Image credit: <https://www.hi-lite-systems.com/projects/aluminum-drop-leg-fly-forms-chennai-india/>

# Fly forms



Image credit: <https://skyriscities.com/news/2015/12/explainer-fly-forms>

# Formwork



# Rebar



Three horizontal lines for text input, enclosed in a yellow L-shaped bracket.

# Pour concrete

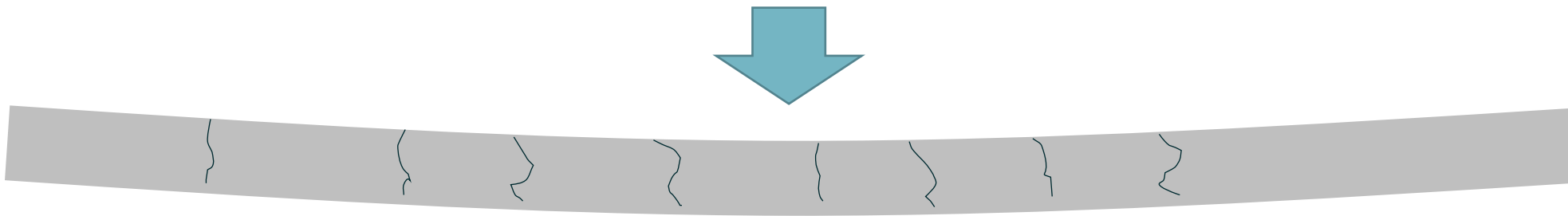




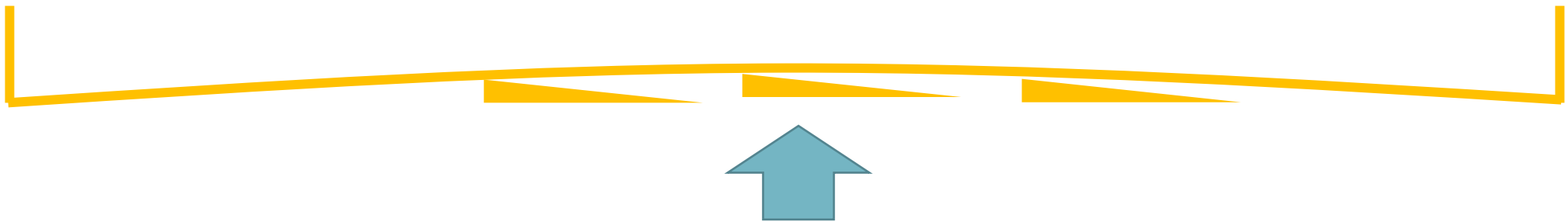
# Completed slab



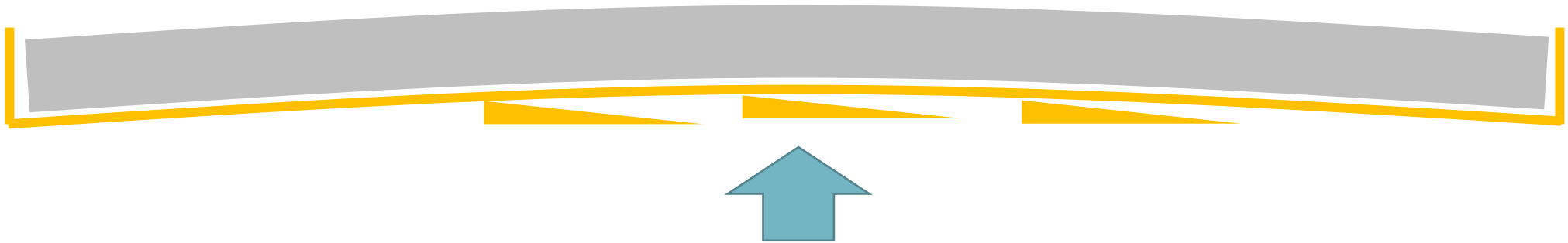
# Problem: deflection and cracking



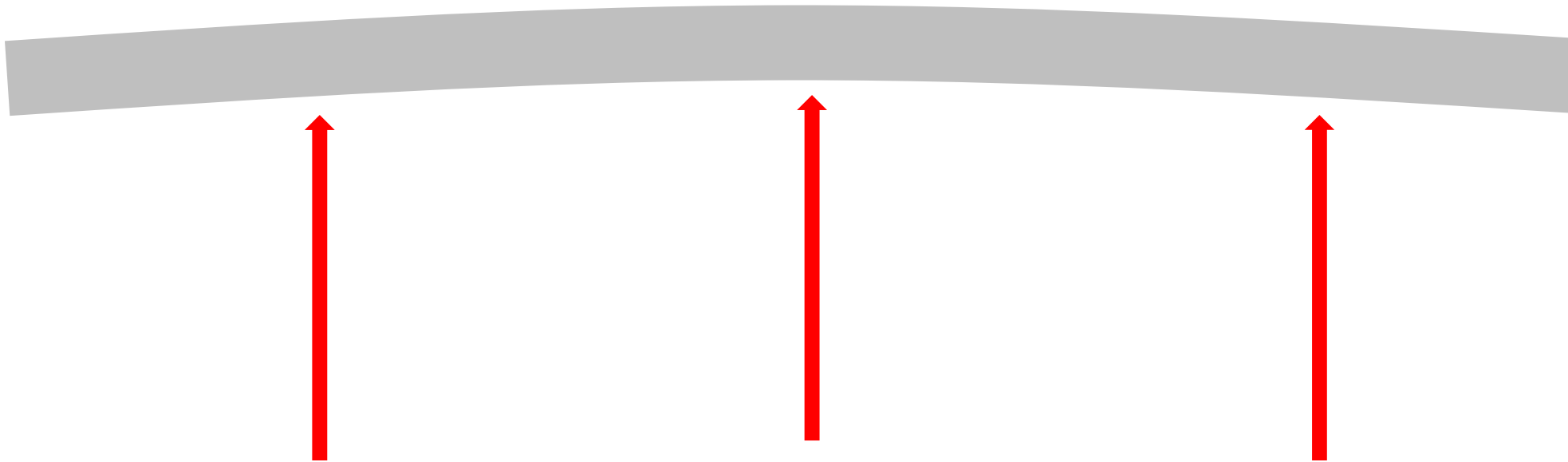
# Camber



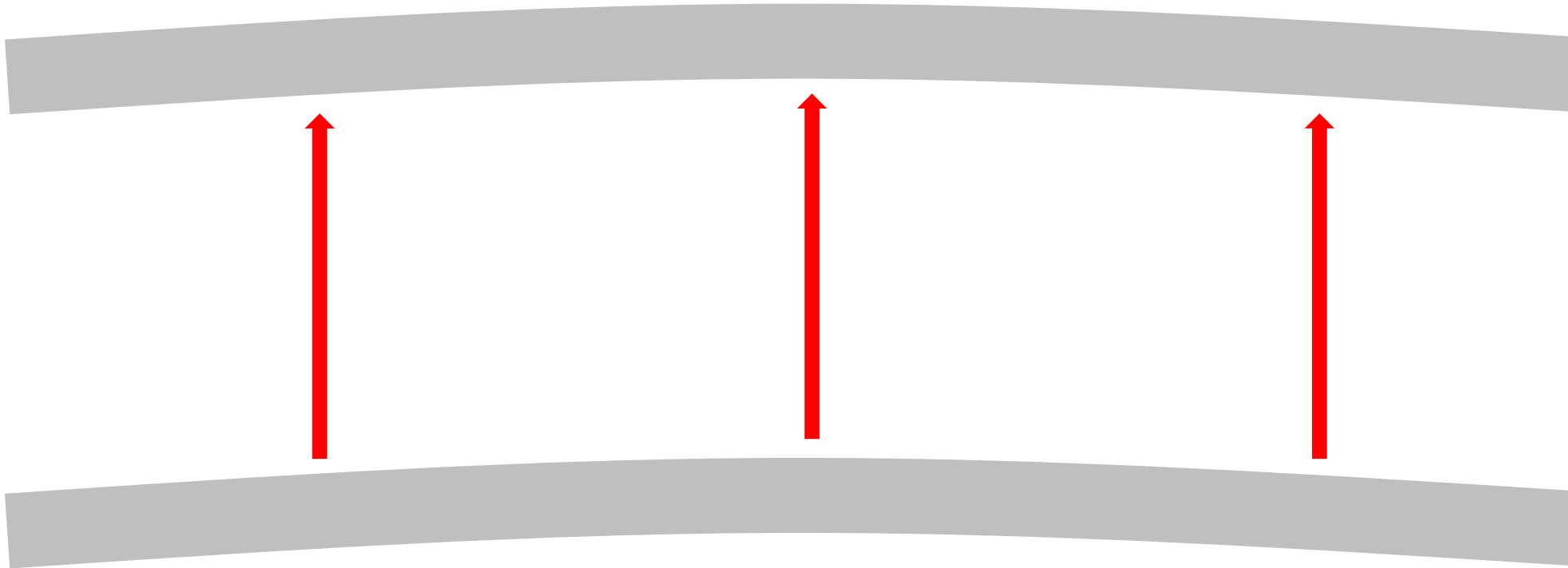
# Camber



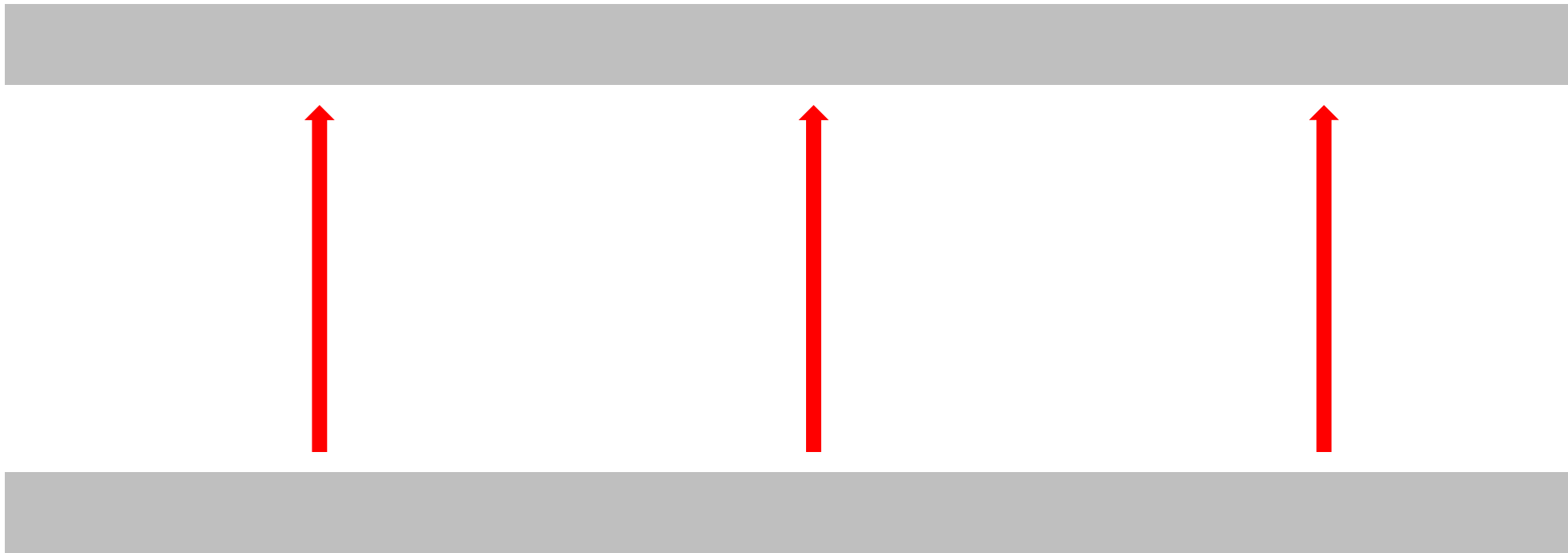
# Reshoring



# Reshoring



# Reshoring



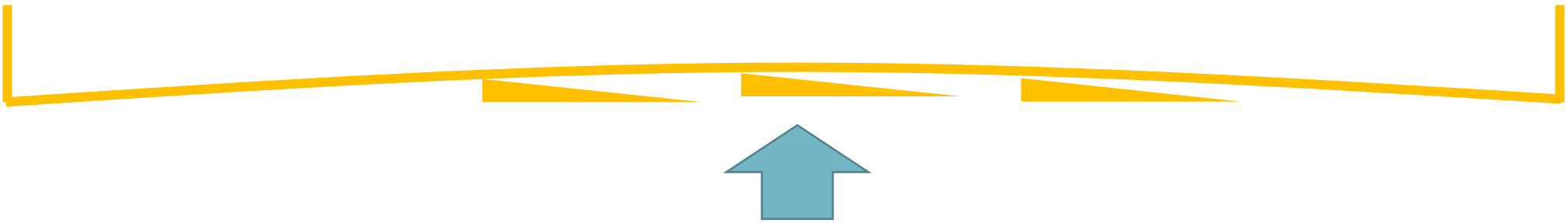
# Completed structure

10 Downing Street “Zoom Quiz”

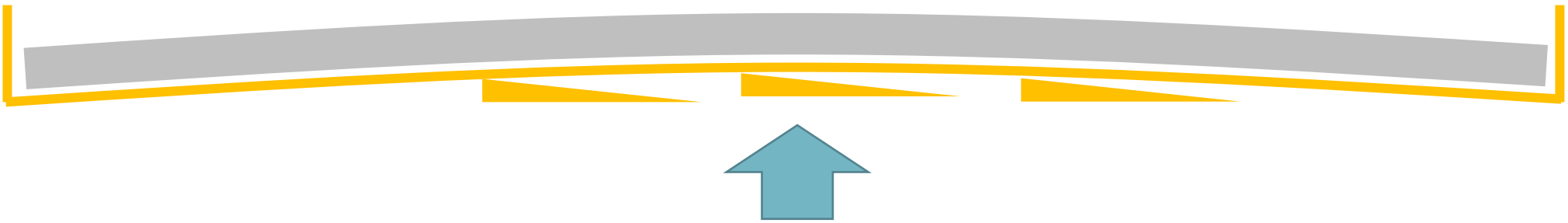




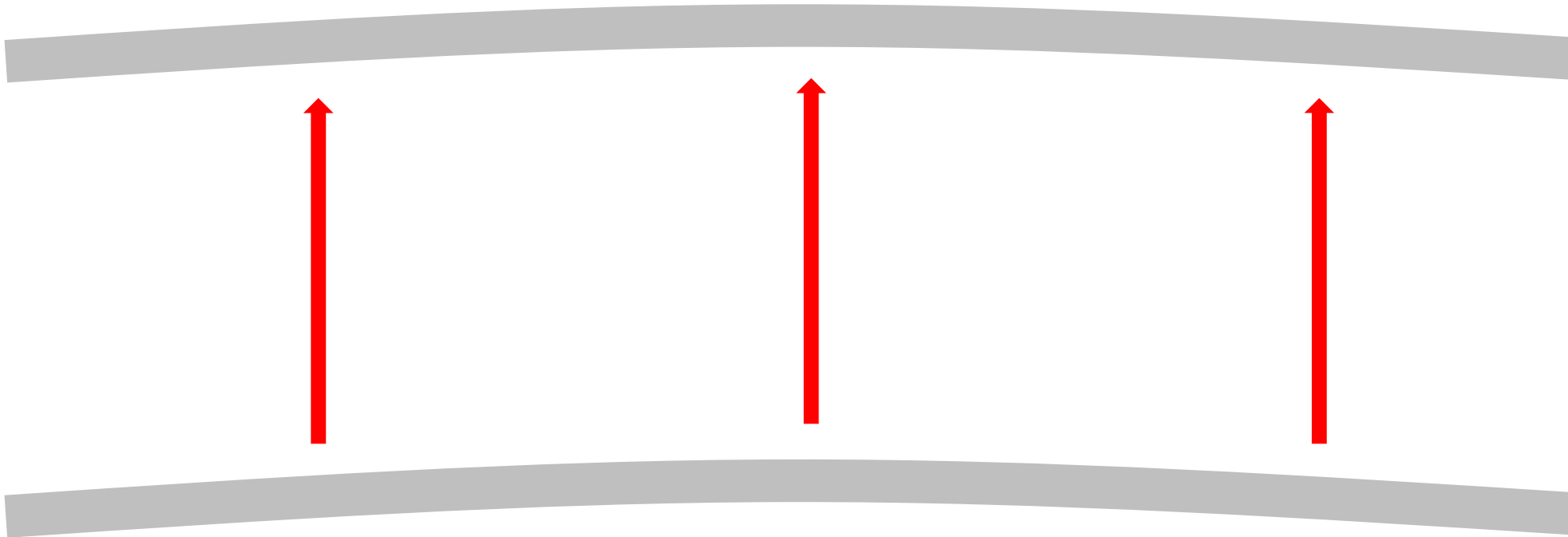
# What went wrong?



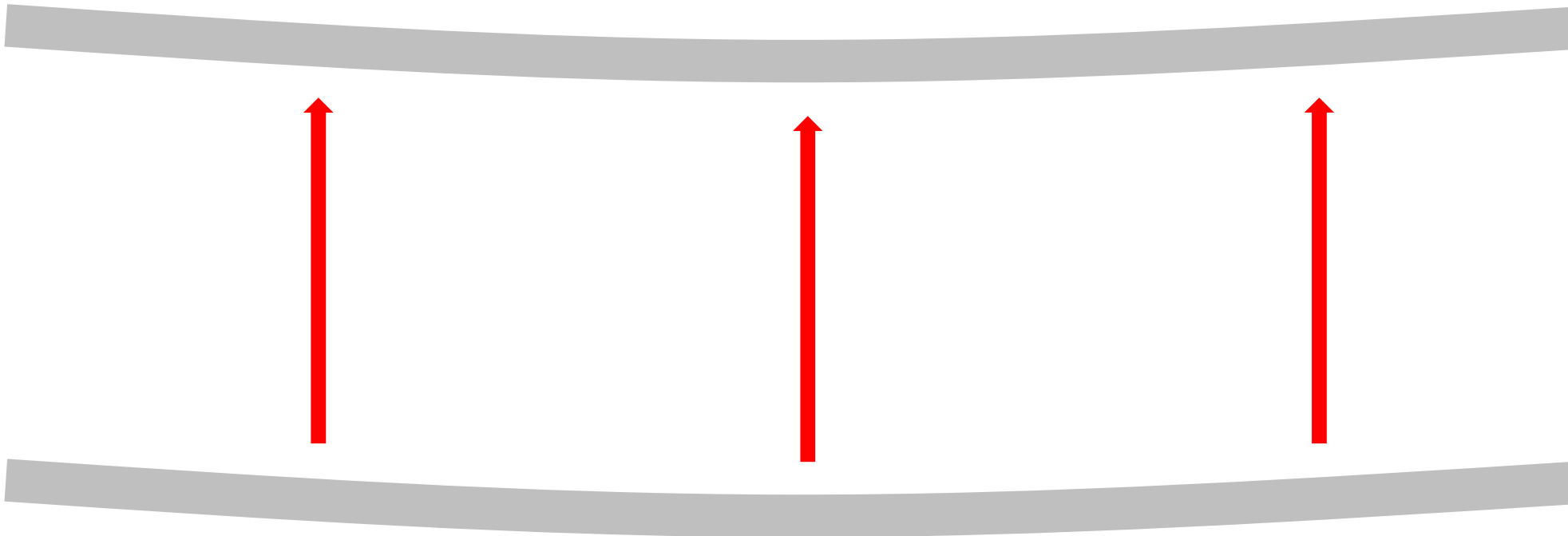
# What went wrong?



# What went wrong?



# What went wrong?



# LEG 2/96 analysis

- What was the damage?
  - Overdeflection of slab
  - Bending and cracking
  - Bending to rebar

# LEG 2/96 analysis

- What was the cause of the damage?
  - *“Failure of the formwork/reshoring procedures to account for the unusually thin design of the slabs”*
  - Slab design itself was not defective

# LEG 2/96 analysis

- What was the cost of rectifying the defect immediately before the damage?
  - *“Applying clause 5(b), the excluded costs are those that would have remedied or rectified the defect before the cracking and over deflections occurred i.e the costs of implementing proper formwork and shoring/reshoring procedures or incorporating additional camber into the formwork.”*
  - *“There was no evidence on which to quantify these costs except to say that they would have been minimal.”*

# On appeal

- Insurers argued that judge had wrongly equated LEG 2 deduction with cost of avoidance.
- LEG 2 had been interpreted to provide equivalent cover to LEG 3.



# On appeal

- The Court of Appeal rejected these arguments.
- Cost of avoidance is conceptually distinct from LEG 2 deduction...
- ... but here the amounts coincidentally the same.

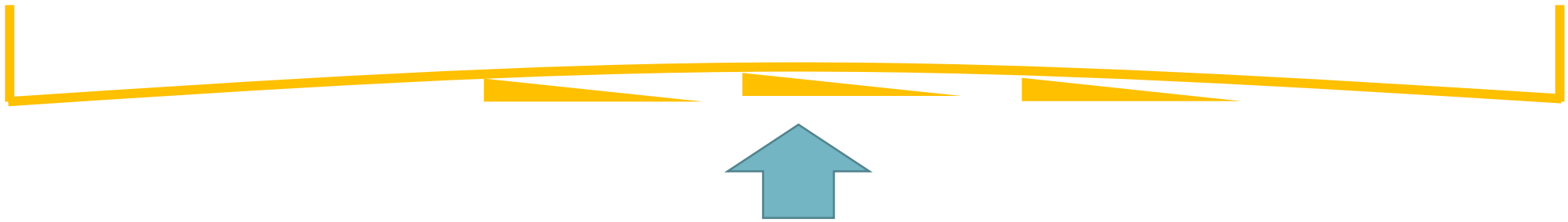
# On appeal

*“Up to the moment of the over-deflection of the concrete slabs, the defect in the workmanship could have been repaired by incurring the costs of adjusting or supplementing the support structures. Accordingly, those are the only costs that fall within the exclusion, on the LEG 2 wording. Those are the same costs (possibly subject to additional costs such as mobilization/demobilization), that would have been incurred to do the job correctly in the first place. That is not why those costs are excluded; they are excluded because they are the costs that would have been incurred, just prior to the over-deflection, to repair or rectify that portion of the property suffering from the defective workmanship.”*

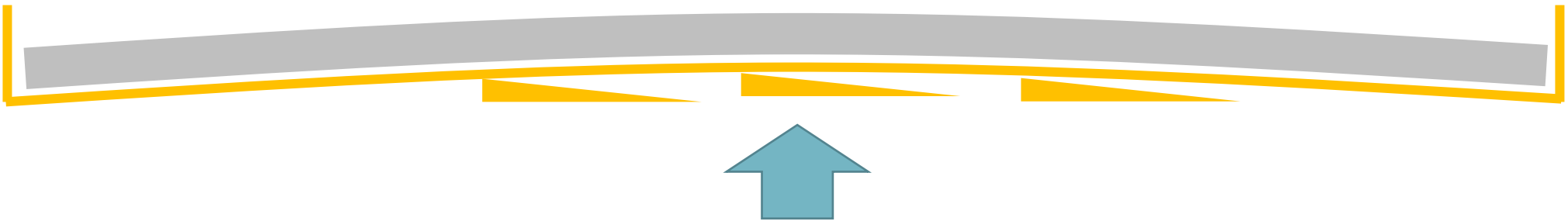
# On appeal



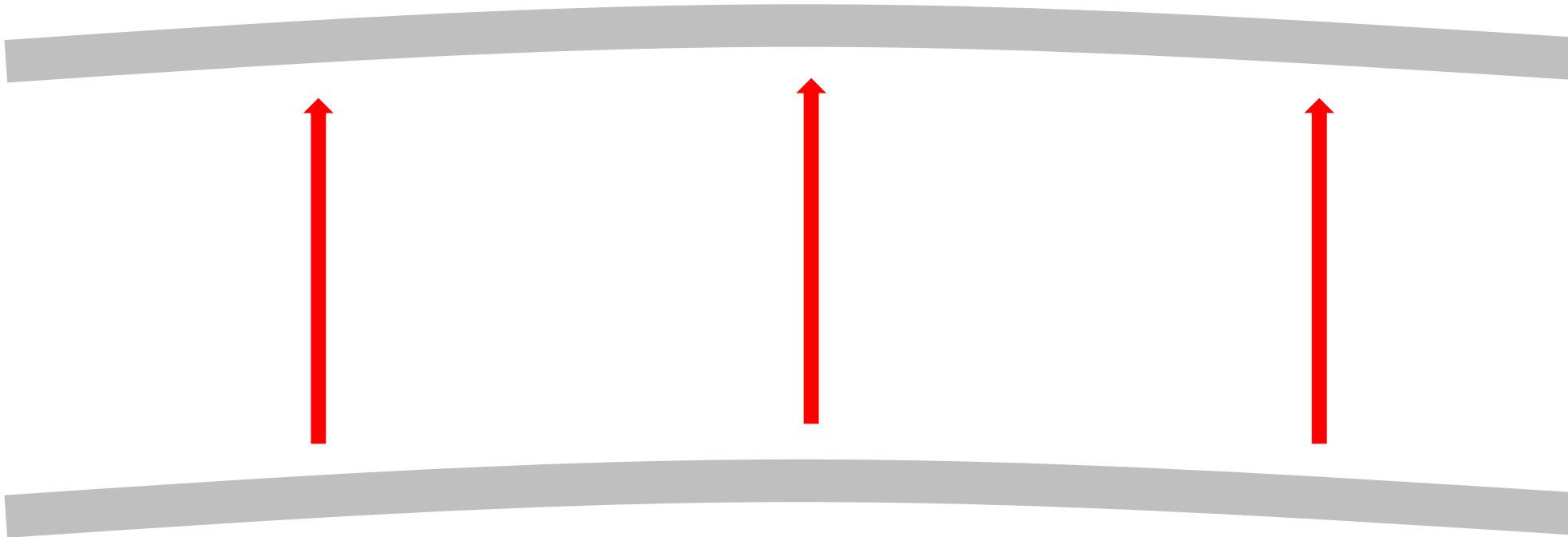
# On appeal



# On appeal



# On appeal



# Conclusions

- Principles are easily stated, but...
- Significant care is needed when applying in practice!
- Must locate the analysis correctly at the point in time immediately before the damage.

# LEG 3



# LEG 3/96

*The Insurer(s) shall not be liable for*

*All costs rendered necessary by defects of material workmanship design plan specification and should damage 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.*

# LEG 3/06

*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 the 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*

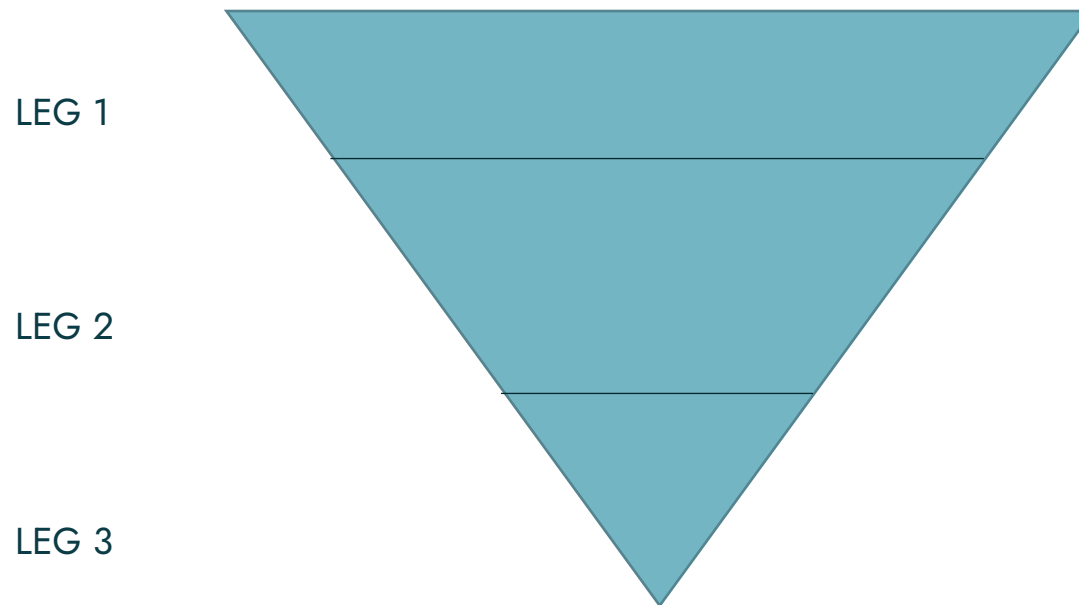
# LEG 3/96 - Exclusion

*All costs rendered necessary by defects of material workmanship design plan specification ...*

## LEG 3/96 – Write back

*... and should damage 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*

# LEG 3/96 – market intention



## LEG 3/96 – “cost to improve”

*“the cost of replacement or rectification which is hereby excluded is **that cost incurred to improve** the original material workmanship design plan or specification”*

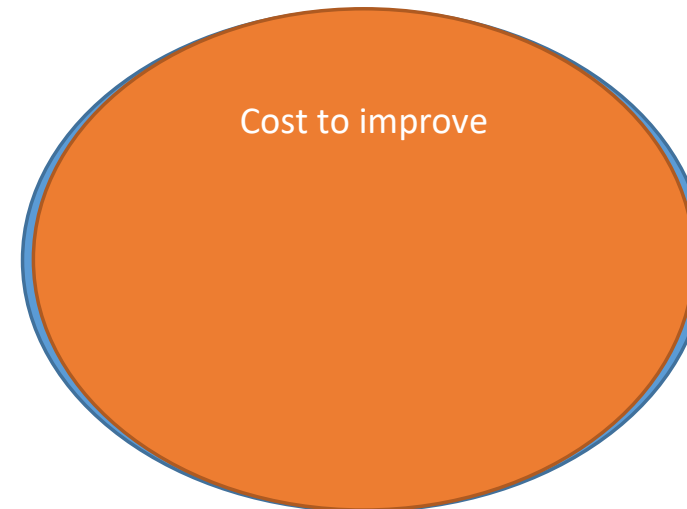
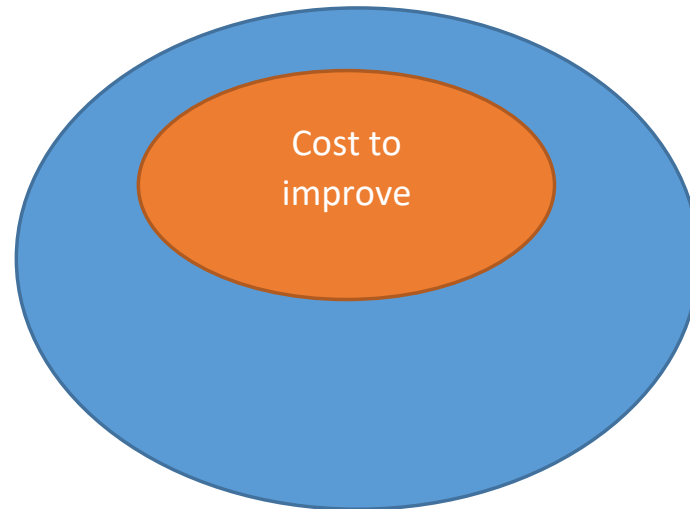
## LEG 3/96 – entire cost to improve

- Insurance policies do not provide an indemnity for defects
- So clause does not write back all remedial costs caused by the defect – would leave initial exclusion without any meaning

# LEG 3/96 – entire cost to improve

**A. Cost to improve less than repair cost**

**B. Cost to improve is the same as repair cost.**





# LEG 3/96 – cost of improvement

- Excluding only the cost which exceeds the cost to repair the damage

## LEG 2 and 3 – damage to non-defective portion

- If not caused by defective – covered
- What about if caused by defect?

# LEG 2 and 3 – damage to non-defective portion

## LEG 2

*The Insurer(s) shall not be liable for*

*All costs rendered necessary by defects of material workmanship design plan specification and should damage 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 which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.*

## LEG 3

*The Insurer(s) shall not be liable for*

*All costs rendered necessary by defects of material workmanship design plan specification and should damage 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*

# Thank you!

Any questions?

---

[david.pliener@gatehouselaw.co.uk](mailto:david.pliener@gatehouselaw.co.uk)

[simon.kerry@gatehouselaw.co.uk](mailto:simon.kerry@gatehouselaw.co.uk)

[louis.zvesper@gatehouselaw.co.uk](mailto:louis.zvesper@gatehouselaw.co.uk)