

Construction all risks insurance – challenges with LEG3 coverage

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Construction all risks insurance – what's covered?

What isn't covered?

Additional coverage – LEG3

Challenges

Construction all risks insurance – what's covered?

In Denmark, construction all risks insurance covers damage in connection with a construction – whether it is being built, added to or rebuilt. It is an 'all risk' insurance, which means that most damage is covered unless directly excluded in the insurance terms.

The insurance is largely based on the English standard terms for all risks insurance (contractors' all risks and erection all risks) and may include the following coverage:

- insurance of the contract (all risk insurance);
- insurance of existing buildings; and
- liability insurance.

With respect to insurance of the contract, physical loss of and damage to the insured items as a result of any unforeseen event is covered.

What isn't covered?

In general, the insurance conditions for construction all risks insurance contain the following exception:

5.1.2 What is not covered by the insurance

...

- *damage due to wear, rust and other gradual deterioration, or inadequately performed work, inadequate materials or inadequate execution of design, calculation or construction. This exception is limited to the part of the work object which includes the worn, deteriorated or defective part which is directly affected by the damage, but does not relate to other parts of the work object which are damaged as a secondary consequence of a primary damage.*

Thus, usual construction insurance does not cover primary damage.

Additional coverage – LEG3

As several players in the construction industry demanded coverage of primary damage (often for the sake of progressing with construction), the London Engineering Group (LEG) introduced the so-called 'LEG3/96' coverage in 1996, which covers both secondary and primary damage. The only exception to LEG3 coverage is costs incurred to improve the original material workmanship design plan or specification, if the defect had been found and rectified before the occurrence of the insurance event (damage). The coverage was later updated with the LEG3/06 version.

In several Danish policies, LEG3 coverage has been inserted with the abovementioned exception replaced with the following wording:

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

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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.

Regardless of the deductible policy, the deductible in connection with damage as a result of the above is DKK 250,000.

LEG3 coverage is often referred to as 'coverage' but, as seen above, it is more of a limitation of the original exception. With the choice of LEG3, it is intended that reported damage should be covered by said exemption in fewer cases. Therefore, the policyholder and the insured should be entitled to better coverage than if they did not have LEG3.

Challenges

However, in Denmark, insurers have generally offered LEG3 coverage to insureds without describing how it is to be understood or advising on the challenges of choosing LEG3.

First, in several cases, LEG3 coverage has been inserted into a policy in English. When, during the sales process, reference is made to the international recognition of LEG3, this opens up for discussion the matter of whether LEG3 should be understood in Denmark in the same way as in the United Kingdom or whether a distinctive practice should be created. That has yet to be clarified in Danish law.

Second, there is virtually no Danish case law and limited UK rulings on LEG3 coverage.

Third, the issue of deductibles continues to present challenges. In the case of several insurers, the deductible when purchasing LEG3 increases considerably for all claims, including claims that are not covered by the LEG3 coverage. This seems to contravene insurers' obligation under Section 31 of the Executive Order on Good Practice for Financial Undertakings to highlight to policyholders when they make a choice in connection with taking out insurance where they will incur premiums or where there are coverage consequences.

Based on the above, parties should seek advice before taking out construction insurance or reporting construction damage to their insurer.

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