Marine Builder's Risk Insurance in the United States

Adron Beene

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Tulane University Law School

Introduction

U.S. Shipbuilding is a twenty two billion dollar a year industry.[1] Shipbuilding imposes significant financial, technical, and logistical challenges on both builders and ship-owners. Accidents happen in shipbuilding: weather can damage incomplete ships, launchings may go poorly, and fire is always a significant risk. While some commercial[2] and government[3] shipbuilding projects are self-insured, to protect their interests, many vessel owners require builders to obtain marine builder's risk insurance. This paper will discuss this specialized type of insurance including the policies used and some common claims that have resulted between the builders, owners, and insurers.

Policy Forms[4]

Marine builder's risk insurance contracts are negotiated between the builder, its broker, and various underwriters including those at Lloyd's and U.S. insurance companies. Once the risk has been subscribed to by underwriters, a contractual document is issued to the builder in the form of a builder's risk policy. Two common policy forms issued in the U.S. are Lloyd's Institute Clauses for Builders' Risks and the American Institute for Marine Underwriter's (AIMU) Builder's Risk Clauses.

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[1]U.S. Census Bureau: Annual Survey of Manufactures: General Statistics: Statistics for Industry Groups and Industries: 2011 and 2010

[2] "The contract did not require Dravo [the builder] to carry builder's risk insurance"
Dravo Corp. v. Litton Sys., Inc., 379 F. Supp. 37, 39 (S.D. Miss. 1974)

[3] "Builder's risk insurance was eliminated only for CPFF contractors."
Johns-Manville Corp. v. United States, 13 Cl. Ct. 72, 106 (1987) vacated, 855 F.2d 1571 (Fed. Cir. 1988)

[4]Lloyd's Institute Clauses for Builders' Risks and American Institute for Marine Underwriter's Builder's Risk Clauses

The structure of these policies is similar; the following bullet points show the general structure:

- The assured, commonly the builder and/or owner, is defined.
- The vessel and the location of the yard are defined.
- Duration for the risk is set, but the policy will terminate upon delivery of the vessel to the owners if it occurs prior to the end date set in the policy.
- Provisions for extending coverage should the vessel not deliver by the original end date in the policy
- The ship is valued based on the final contract price.
    - This value is the insurer's upper limit under a total loss scenario in addition to sue and labor.
- Coverage and exclusions are defined including:
    - Coverage within a 250 mile radius of the builder's yard
    - Collision coverage
    - Sue and labor
    - Defective design exclusion
    - Other exclusions discussed below

Some differences between the policies:

- Hull, machinery and equipment under construction at other yards or by subcontractors is covered but must be specifically defined under the Lloyd's policy. The AIMU policy covers hull and material "destined" for the vessel, but no specific provision is included for hull and material at sites other than the builder's yard.

- Amount insured, premiums, deductibles and the ship's agreed value are written directly into the AIMU policy, but not in the Lloyd's policy.

These policies[5] provide "all risk" coverage to the builder.

> Marine insurance, including salvage work, was provided on an "all risks" basis, reflecting the inherent uncertainties and multiple perils that involve work at sea. When marine insurers first began underwriting builder's risk insurance some created "inland marine" underwriting departments, which continued using "all risk" forms of insurance.[6]

The policies provide some exclusion for losses due to War, Strikes, Malicious Acts and Nuclear Incidents. In addition to exclusions named in the policies, courts have found that "All Risks" does not cover everything.[7] These cases will be discussed below.

Jurisdiction and Governing Law

When disagreements between builders, owners, and insurers can't be resolved through dispute resolution and arbitration, these policies come under review by the courts. Marine insurance contracts, including marine builder's risk, are under Admiralty Jurisdiction.[8] Admiralty jurisdiction gives the federal courts the ability to hear these cases as provided by the Constitution under Article 3 Section 2. However, the "savings to suitors" clause of 28 USC § 1331 provides

[5] Lloyd's Institute Clauses for Builders' Risks; American Institute for Marine Underwriter's Builder's Risk Clauses
[6] Construction Briefings No. 2005-6
[7] Trinity Industries, Inc. v. Insurance Co. of North America, 916 F.2d 267 (1990)
[8] "A marine insurance contract is a marine contract within federal admiralty jurisdiction."
AGIP Petroleum Co., Inc. v. Gulf Island Fabrication, Inc., 920 F. Supp. 1318, 1322 (S.D. Tex. 1996)

that these claims may be filed in State Courts. Builder's risk cases have also been brought on diversity jurisdiction[9]. Another factor that can help push builders' cases into state court is "the interesting factor that traditionally contracts for the construction of a ship are not ordinarily within the Article III maritime and admiralty jurisdiction."[10] The U.S. Supreme court has made the same finding in *Kossik v. United Fruit*: "certain common types of contract: a contract to repair, or to insure a ship, is maritime, but a contract to build a ship is not."[11] Litigation over builder's risk contracts and shipbuilding contracts is often intertwined.

Governing law in Marine Insurance cases was defined by the Supreme Court in its decision in *Wilburn Boat*.[12] In its holding, the court left the regulation of marine insurance contracts to the states:

> Under our present system of diverse state regulations, which is as old as the Union, the insurance business has become one of the great enterprises of the Nation. Congress has been exceedingly cautious about disturbing this system, even as to marine insurance where congressional power is undoubted. We, like Congress, leave the regulation of marine insurance where it has been-with the States.[13]

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[9]Fireman's Fund Ins. Co. v. Sneed's Shipbuilding, Inc., 803 F. Supp. 2d 530, 533 (E.D. La. 2011); Dravo Corp. v. Litton Sys., Inc., 379 F. Supp. 37, 39 (S.D. Miss. 1974); Magnum Marine Corp., N.V. v. Great Am. Ins. Co., 835 F.2d 265, 266 (11th Cir. 1988)
[10] Walter v. Marine Office of Am., 537 F.2d 89, 94 (5th Cir. 1976)
[11] Kossick v. United Fruit Co., 365 U.S. 731, 735, 81 S. Ct. 886, 890, 6 L. Ed. 2d 56 (1961)
[12] Wilburn Boat Co. v. Fireman's Fund Ins. Co., 348 U.S. 310, 75 S. Ct. 368, 99 L. Ed. 337 (1955)
[13] Ibid.

Marine Builder's Risk Insurance contracts with Lloyd's are "subject to English law and practice"[14] and the choice of law and venue clauses in marine insurance contracts was upheld in *Richards v. Lloyds of London.*[15] The 5th Circuit en banc found that U.S. plaintiffs had sufficient remedies available to them under English Law and in English Courts, and upheld the choice clauses in the policy. This paper will focus on cases heard in the U.S., and the AIMU Builder's Risk Clauses. This does not mean, however, that cases involving Lloyd's insurance contracts are not heard in the U.S.[16]

Claims

Coverage of Contractual Claims under 'All Risk" Policies

When the delivery of a ship is delayed, the owner suffers a loss of use of the vessel. To protect themselves from this loss, owners write into the contract a clause for the builder to pay liquidated damages should the vessel deliver late. These damages are called contractual damages, as they are part of the contract between the builder and the owner.

In *Stanley v. Onetta Boat Works,*[17] decided in 1969 by the U.S. District Court in Oregon, the builder's insurer was found liable to pay for loss of use. Onetta Boat Works delivered a vessel that was not seaworthy. The repair of the unseaworthy condition led to lost fishing days for the vessel's owner and Onetta was found liable for the owner's lost profits for the season. The Court found that Onetta was covered for these contractual damages (the unseaworthy state was a

[14] Lloyd's Institute Clauses for Builders' Risks
[15] Richards v. Lloyds of London, 135 F,3d 1289 (5th Cir 1998)
[16] Certain Underwriters at Lloyd's v. Montford, 52 F.3d 219 (1995)
[17] Stanley v. Onetta Boat Works, Inc., 303 F. Supp. 99, 106 (D. Or. 1969) aff'd, 431 F.2d 241 (9th Cir. 1970)

breach of contract) under its builder's risk policy with Union Insurance. The court overcame obstacles within the policy in its finding. The policy excluded consequential damages or loss from delay, and it expired upon vessel delivery. The court reasoned:

> 'All Risk' insurance policies have been construed in many cases, including *C. H. Leavell & Co. v. Fireman's Fund Ins. Co.*, 372 F.2d 784 (9th Cir. 1967), where it is said that such a policy creates a special type of coverage extending to risk not usually covered by other policies and that recovery under an 'All Risk' policy will be allowed for all fortuitous losses not resulting from misconduct or fraud, unless the policy contains a specific provision, expressly excluding the loss from coverage.[18]

Damage that flowed from defects had been built into the ship, and from a mishap at launching, was not consequential damage and covered in the "all risk" policy. This decision has been significantly narrowed by the following cases. It seems that the "special type of coverage" for an "all risk policy" is eroding.

A more recent case, *Bender v. Brasileiro*[19] shows that the expansive coverage of contractual damages in *Stanley* may no longer be available to builders. While not negatively treating *Stanley*, the decision here significantly narrows the holding. In *Bender*, sections of drydock under construction for Todd Shipbuilding broke loose and were damaged. The repair of the damages caused a delayed delivery to Todd. Todd made a claim against Bender under its liquidated

[18] Stanley v. Onetta Boat Works, Inc., 303 F. Supp. 99, 106 (D. Or. 1969) aff'd, 431 F.2d 241 (9th Cir. 1970)
[19] Bender Shipbuilding & Repair Co., Inc. v. Brasileiro, 874 F.2d 1551, 1553 (11th Cir. 1989)

damages clause for late delivery. Bender contacted its builder's risk insurer, Hartford. Hartford had sold Bender a policy based on the American Institute Builder's Risk Clauses.

Bender made a claim under the collision liability clause for defense from Todd's suit. Hartford denied the claim. Bender settled with Todd for over $350K. Bender then brought suit in District court against Hartford and was successful. Hartford then appealed to the 11th Circuit.

In its decision, the appellate court found that the district court erred in extending coverage for liquidated damages to Bender under the builder's risk policy. It reasoned that Hartford:

> By issuing the Hull Risks policy, did not undertake to protect Todd from all risks involving construction of the drydock, especially contractual risks of which the Hartford apparently had no knowledge. The terms of the separate Bender-Todd contract were not incorporated into the Hull Risks policy, nor was any such incorporation necessary to accomplish the goals of the policy. To extend the coverage of the Hull Risks policy or the Collision Liability clause to the type of risks which Bender created by entering the contract with Todd would greatly expand the intended coverage of the policy and clause and likely result in higher premiums to account for the additional risks covered.

From *Bender*, it is apparent that contractual damages are no longer covered by the "all risk" policy.

Defective Workmanship

In addition to contractual damages, courts have interpreted "all risk" builder's insurance policies to not cover losses from the repair of defective workmanship. *Trinity Industries, INC v.*

Insurance Company of North America provides an example of how U.S. courts deal with defective workmanship[20]. In the 1980s, Halter Marine, a medium size shipbuilder in the U.S., built 180' supply boats for Leam, an offshore oil and gas drilling company. One of these vessels, the M/V Leam Alabama, was discovered to have been built with a twist in the hull, making the vessel difficult to trim, an important part of keeping the vessel stable. An arbitration panel found that the twist violated the warranty of workmanlike performance under the construction contract and awarded Leam $2.3M. Halter had taken out builder's risk insurance, as a condition of the construction contract with Leam. Insurance Company of North America (INA) insured Halter under the American Institute Builder's Risk Clauses form. This policy insured "against all risks of physical loss of or damage."

After the arbitration award was upheld in court, Halter formally demanded reimbursement from INA. INA refused and Halter brought suit in The U.S. District Court for the Eastern District of Louisiana. In trial court Halter prevailed, with the Louisiana District court finding that the arbitration award was covered under the policy; INA appealed. On appeal, the 5th Circuit overturned. Halter argued that defective workmanship was covered under the policy with INA, and that the twist was damage. Judge Wisdom was not swayed by Halter's argument and reasoned:

> We have trouble with the notion that a Builder's Risk policy covers the cost incurred by the policyholder to correct faulty workmanship. While we recognize that courts, including ourselves, have used broad language in describing the extent

[20] Trinity Indus., Inc. v. Ins. Co. of N. Am., 916 F.2d 267, 269 (5th Cir. 1990)

> of the coverage provided by an all risks policy, we are convinced that neither party intended for the Builder's Risk policy to cover the cost of repairing plaintiff's mistakes in construction.[21]

The court interpreted "physical loss or damage" as not including the cost to repair defective workmanship. But even if it had, Halter's claim against INA had not been filed for recovery due to the twist, but recovery of the arbitration amount awarded to Leam. Following the decision in *Bender v. Brasileiro*[22], discussed above, the court held that the builder's risk policy did not cover contractual risks to Leam. In addition, the court ruled that attorney fees incurred by Halter defending the initial claim from Leam were not covered under the sue and labor clause.

An argument can be made that, by interpreting losses due to defective workmanship as not covered under an "all risk" policy, the policy effectively insures no risks.[23] This is because most builders' risks claims can be tied at some point to an error in workmanship. The 5th circuit combatted this argument by distinguishing Trinity, stating:

> We are mindful of the many cases that have found defective workmanship to be a risk covered by all risk policies. These cases, however, have dealt with an accident caused by defective workmanship, not with the cost of replacing or repairing defective workmanship. [24]

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[21] Trinity Indus., Inc. v. Ins. Co. of N. Am., 916 F.2d 267, 269 (5th Cir. 1990)
[22] Bender Shipbuilding & Repair Co., Inc. v. Brasileiro, 874 F.2d 1551, 1553 (11th Cir. 1989)
[23] Construction Briefings No. 2005-6
[24] Trinity Indus., Inc. v. Ins. Co. of N. Am., 916 F.2d 267, 270 (5th Cir. 1990)

Therefore, if the boat in Trinity had experienced an accident, such as capsizing at pier due to stability issues brought on by the twist, the fact that the twist was due to defective workmanship would not bar recovery from the loss due to the capsize.

A Texas Appeals court followed reasoning similar to *Trinity* in *North American Shipbuilding v. Southern Marine & Aviation Underwriting*.[25] In 1990 North American contracted to construct a ship. North American purchased a builder's risk policy (American Institute Builder's Risk Clauses form) from Southern Marine, a wholesale broker. This policy was insured by a Lloyd's underwriter. During construction, North American found that it had faulty welds in the vessel. The builder traced the cause to improperly mixed welding gas from its supplier. North American repaired the welds and filed a $1M insurance claim for the repair cost. The Lloyds underwriter denied coverage and North American sued in Texas state court. The trial court granted summary judgment in favor of the underwriter on its motion that "faulty initial construction does not constitute "physical loss of or damage to" the vessel under a builder's risk policy and therefore is not covered."[26]

On appeal, North American attempted to distinguish their case from *Trinity*. First North American stated that Texas contract interpretation principles differed from Louisiana. The Texas Appeals court disagreed; finding the contract interpretation principle in Louisiana "intentions of the parties, as determined by policy language, determine the extent of coverage" was the same in Texas.[27]

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[25] N. Am. Shipbuilding, Inc. v. S. Marine & Aviation Underwriting, Inc., 930 S.W.2d 829 (Tex. App. 1996)
[26] N. Am. Shipbuilding, Inc. v. S. Marine & Aviation Underwriting, Inc., 930 S.W.2d 829 (Tex. App. 1996)
[27] Ibid.

Next, North American argued that the damages were due to its supplier, and not a contractual liability. The court found that the *Trinity* decision was not based solely on non-coverage of contractual risks, but also that the term "physical loss and damage" did not include defective workmanship.

The third argument North American brought forth was that unlike *Trinity*, where the twist was not immediate and could be managed without immediate repair, fixing the faulty welds was necessary and performed immediately. The Texas court again on the *Trinity* interpretation of "physical loss or damage" that because the welds were defective to begin with, there was no loss or damage.

North American's fourth contention was that it differed from the plaintiffs in *Trinity* because the faulty welds were not its fault. The court found that North American misinterpreted the holding in *Trinity*:

> Under North American's interpretation, a builder's risk policy effectively would guarantee the quality of every component used in a vessel's construction, as long as the builder was not at fault in the way it used the component. This interpretation transforms a builder's risk policy into a performance bond.[28]

[28] N. Am. Shipbuilding, Inc. v. S. Marine & Aviation Underwriting, Inc., 930 S.W.2d 829, 834 (Tex. App. 1996)

North American made a fifth contention that an "all risk" policy covers "all risks except those specifically excluded."[29] The court's response was that defective workmanship need not be specifically excluded as "they are not covered to begin with."[30]

Finally, North American argued that it intended the contract to cover losses from defective workmanship. The court held that the policy is to be interpreted by its language, not intent.

A third case, *Fireman's Fund v. Sneed's Shipbuilding*[31], decided in 2011 by The U.S. District Court for the Eastern District of Louisiana, also followed *Trinity*. Sneed contracted to build a drydock for Superior Shipyard and Fabrication. Superior sued Sneed for breach of contract for failing to meet contract specifications due to defective workmanship. The defects included faulty welds, gouges in the dock, defective coating application leading to rust, painting over dirt and sand, and other workmanship issues found during the vessel's trials. Fireman's fund insured Sneeds under an "all risks" builder's policy.

When Sneed requested indemnity from Superior's claim, Fireman's denied the claim and filed an action for declaratory judgment. Sneed argued that the gouges represent physical accidents; however, Sneed's President had said that no collisions had occurred, and Sneed did not present evidence to show an accident had occurred. Sneed also tried to argue that rust was a separate "accidental occurrence resulting from faulty workmanship."[32] The court saw there might be room for this argument as the *Trinity* decision allows coverage for separate accidents that result from defective workmanship.

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[29] Ibid.
[30] Ibid.
[31] Fireman's Fund Ins. Co. v. Sneed's Shipbuilding, Inc., 803 F. Supp. 2d 530, 533 (E.D. La. 2011)
[32] Fireman's Fund Ins. Co. v. Sneed's Shipbuilding, Inc., 803 F. Supp. 2d 530, 536 (E.D. La. 2011)

The cases cited by Sneed all dealt with defective workmanship causing damage in a separate event to another's product, where the damaged dry-dock was Sneed's own product. As held in *Trinity*, in order for there to be an accident, a distinct event had to occur. Here, Sneed had built defects into the drydock, leading to the rust. There was no initial state in which the coating was good, therefore the rust was part of the inherent defect. The court did not find the rust to be a distinct event from the application of improper coating.

The decisions in the above cases shows that repairs due to defective workmanship are not covered under "all risk" builder's policies. *Trinity* left the door open for accidents caused by defective workmanship to be covered as long as they were a "discrete event that a reasonable person would call an accident."[33] It can be inferred from the *North American* case that "discrete event" does not include defective workmanship requiring immediate and necessary repair. *Fireman's Fund* further limited the definition of an accident as there was no coverage even when hull damage was present and defective workmanship led to premature rusting. Classifying what is and what is not an accident appears to be the key in defective workmanship claims.

Design Changes

When an insurer signs a contract to insure a vessel, it expects to be notified of any material changes in the vessel. This prevents the builder from changing the ship design to one more hazardous to build without a commensurate increase in premium. The AIMU policy on design changes reads:

> In the event of any material change in the specifications or design of the Vessel

[33] Trinity Indus., Inc. v. Ins. Co. of N. Am., 916 F.2d 267, 270 (5th Cir. 1990)

> from that originally represented to the Underwriters, such change is held covered provided (a) notice is given to Underwriters immediately following such change, and (b) any amended terms of cover and any additional premium required by the Underwriters are agreed to by the Assured.[34]

This clause was interpreted in an unreported case by the U.S. District Court in the Eastern District of Louisiana in *Felham Enterprises v. Certain Underwriters at Lloyds.*[35] In *Felham*, a yacht under construction at Trinity Yachts and insured by Zurich caught fire. Halter had hired Trinity to build the yacht and had taken out an AIMU builder's risk policy with Zurich. Zurich alleged that the yacht would not have met classification standards, and therefore that the specifications had materially changed. However, Zurich failed to obtain specifications or drawings of the yacht, or even visit the yard. The court held that:

> Because Zurich has not shown that there were any original representations as to the specifications or design of the ULYSSES, Zurich cannot establish that there was any subsequent misrepresentation. Even assuming representations were made to Zurich with respect to the specifications or design of the ULYSSES, Zurich failed to establish that any original representations were ever changed by Halter.[36]

This case shows that it is important for an insurer to obtain and review vessel specifications or else the design change clause will not afford it protection.

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[34] American Institute for Marine Underwriter's Builder's Risk Clauses
[35] Felham Enterprises (Cayman) Ltd. v. Certain Underwriters at Lloyds, CIV.A.02-3588, 2005 WL 2050284 (E.D. La. Aug. 2, 2005)
[36] Felham Enterprises (Cayman) Ltd. v. Certain Underwriters at Lloyds, CIV.A.02-3588, 2005 WL 2050284 (E.D. La. Aug. 2, 2005)

Claims after Policy Expiration

As noted in the policy section above, Marine builder's risk policies expire upon delivery of the vessel to the owner. However, The *Stanley* decision allowed recovery for lost profits experienced after delivery. *Rydman v. Martinolich*[37] did not allow such recovery. Rydman ordered a fishing vessel from Martinolich Shipbuilding. Martiniolich bought a builder's risk policy (AIMU Builder's Risk Clauses form) to cover construction of the vessel. After delivery, the vessel sank. Rydman brought an action to recover for the loss of his vessel in the Washington State Court.

The trial court dismissed Rydman's action and he appealed. The Court of Appeals of Washington applied the following principle in its review of the policy, "Where the language of a contract is unambiguous, the intent of the parties and meaning of the contract are to be determined from the language alone, without resort to other aids of construction."[38] Unlike *Stanley*, there was no discussion of the special nature of "all risk" insurance contracts. Instead, the court upheld the language of the policy: that coverage expired at delivery.

Rydman attempted to argue that *Stanley* applied to his claim. The Washington Appellate Court held that if *Stanley* stood "for the proposition that a builder's risk insurance policy covers some losses occurring after the policy period, we decline to follow it and rely on the sounder principles of contract construction discussed above."[39]

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[37] Rydman v. Martinolich Shipbuilding Corp., 13 Wash. App. 150, 153, 534 P.2d 62, 63 (1975)
[38] Ibid.
[39] Rydman v. Martinolich Shipbuilding Corp., 13 Wash. App. 150, 154, 534 P.2d 62, 64 (1975)

The holdings of *Stanley* continue to erode; the *Rydman* holding leaves little room for builder's risk claims after a vessel has been delivered.

One year later, a decision by the 5th Circuit in *Walter v. Marine Office of America* helped to define delivery.[40] In this case, a vessel capsized as it was being moved from one yard to another. Walter had contracted with Saint Charles Steel works to build the vessel, and had taken out builder's risk policies with Fireman's. Walter had a taken out a mortgage on the vessel with the U.S. Government. The Government's interests were covered under separate builder's risk policies with Penn (under AIMU clauses), and Lloyd's (under Lloyd's Institute Clauses). After much of the work had been completed, the ship, not yet under its own power, was towed to Bollinger Shipyard to be finished. After completion at Bollinger, Saint Charles was to perform testing work on the vessel. During the tow, the vessel capsized. Repairs at Bollinger amounted to $76K.

The 5th Circuit held that, although the ship had left the builder's yard (Saint Charles), delivery had not occurred:

> It is plain from all the policies that the underwriters contemplated that during the continuance of coverage (prior to "delivery") the shipbuilder and the Owner-builder had risks physically removed from the precise situs of the shipyard facilities (see notes 3 and 4, supra). The clear purpose to insure those risks if

[40] Walter v. Marine Office of Am., 537 F.2d 89, 95-96 (5th Cir. 1976)

> otherwise covered reflects the understanding that physical departure from the yard would not ordinarily constitute "delivery."[41]

In situations where a ship is to be transported between yards, it is important for insurers to consider the risks of transit, as delivery of the vessel, when terms are unclear, will be construed in favor of the owner/builder.

Damage to Material Not Yet Attached to a Hull

Depending on the stage of construction, much of the material that will become a vessel will be located in the builder's warehouses or stored within the yard. Although pre-dating the AMIU clauses, *Ira S. Bushey & Sons v. American Insurance Co.*[42] provides precedence that this material is covered under an "all risks" builder's policy. Ira had purchased 1.2 million feet of lumber for the repair and construction of vessels. Before it could be used to repair or build a vessel, over half of the timber caught fire. Ira had an expansive "all risk" builder's insurance policy that covered fire damage while under construction, and included materials in the yard. The insurer denied Ira's claim. Its argument in the Court of Appeals of New York was that the vessel was not yet under construction. The appellate court did not accept this argument and held:

> The policy should be read, if it can be without twisting words and rendering plain meanings nugatory, so as to make the scheme of the policy reasonable and to

[41] Walter v. Marine Office of Am., 537 F.2d 89, 95-96 (5th Cir. 1976)
[42] Ira S. Bushey & Sons v. Am. Ins. Co., 237 N.Y. 24, 28, 142 N.E. 340, 341 (1923)

> protect the builder if a loss to materials on the ground occurs before any of the timbers have been built into the structure.[43]

To support this contention, the court determined that "the building of the boat starts just as soon as you start getting that material ready."[44]

A few years later, Ira was involved again in a dispute with an insurer over coverage of materials in *Ira S. Bushey & Sons v. Homes Insurance Co*.[45] This time a barge that it was building was damaged when the ways upon which it was being constructed collapsed. Ira had an "all risks" builder's insurance policy with Home Insurance Co. Home paid out on the vessel, but not on the ways. Ira brought suit in the New York State Court to recover for the loss of the ways. The ways used by Ira were temporary, and specific to the vessel being built. The policy covered material assigned to the vessel and had specific coverage for "appurtenances, including patterns, molds, etc."[46] The court found that the ways, being specific to that vessel, were covered by that clause. It is likely that the court would not have found in favor of Ira had the ways been a permanent structure at the yard, used for many different vessels.

These two cases show that material that has yet to be put on a vessel, or material not intended to be incorporated into the ship but utilized specifically for that vessel, will be covered under an "all risk" builder's insurance policy.

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[43] Ira S. Bushey & Sons v. Am. Ins. Co., 237 N.Y. 24, 28, 142 N.E. 340, 341 (1923)
[44] Ibid
[45] Ira S. Bushey & Sons v. Home Ins. Co., 127 Misc. 342, 343, 216 N.Y.S. 151 (App. Term 1926)
[46] Ibid.

Ambiguity

Ambiguities in builder's risk policies favor the insured. Therefore, it is in the insurer's best interest to ensure the policy is as clearly written as possible. In *Wheeler v. Aetna*[47], Aetna, the insurer was ordered to pay out a claim for a motorboat that had exploded well after it had been built. Wheeler built motorboats and had shown the subject motorboat at a show in January, 1930. It had taken out a builder's risk policy with Aetna under the AIA Inland Vessel Form. This policy provided general hull policy coverage, "all risks" during construction and included all risk of trials trips within 100 miles of the place of construction. The policy also covered negligence by the master. Extensions of the policy and coverage of the trip taken by the boat had been paid for in effect at the time of the loss.

The trip during which the loss occurred was from Brooklyn to Syracuse. However, it did not go directly from one port to another. The boat experienced engine troubles and pulled into a shipyard at Brewerton. After the repairs a test run was taken with the boat arriving in Ithaca. The vessel exploded after being refueled. The court held that "ambiguous clauses, which may be read in different ways so that on one construction there may be valid insurance protection and on the other no protection must be construed favorably to the insured."[48]

The court also read the entire policy as a single document and developed an expansive view of coverage:

> The risk insured against was not confined to the risk of building the boat, launching it, and giving it one trial. While such clauses are included in the policy

[47] Wheeler v. Aetna Ins. Co., 68 F.2d 30, 32 (2d Cir. 1933)
[48] Wheeler v. Aetna Ins. Co., 68 F.2d 30, 32 (2d Cir. 1933)

> and so it may be called a builder's risk policy, still it is clear enough that the clauses extended beyond one trial. The intention that risk from an explosion was included is plain. The policy referred to 'navigation and use' and stated that 'all risks incidental to steam navigation 'are among the risks covered. A builders' risk policy in general use is liberal in its phrasing and represents the nearest approach to full protection.

The multiple extensions and multiple "all risk" coverage clauses within the policy led to Aetna paying out on a claim far from the builder's yard and long after construction had completed.

Self-Insurance

Common in shipbuilding contracts with the Government, owners can self-insure the builders for builder's risk losses. This can hurt relationships between owners and builders and lead to a lower recovery for the builder than if it had obtained insurance through a third party. In Government contracts, a builder's risk claim leads to drawn out negotiations over the contractor's request for equitable adjustment, of which the Government usually pays half what is claimed.[49] In commercial contracts, it can lead to lawsuits directly between the owner and builder. *Dravo Corp. v. Litton Systems*[50] shows how a builder can get stuck with paying for damages caused by an event that would normally be covered by a builder's risk policy under AIMU clauses.

Dravo was contracted to build a floating drydock for Litton. In the contract, Dravo was not required to take out builder's risk and did not purchase one under AIMU clauses. During

[49] Based on author's direct experience working in the shipbuilding industry
[50] Dravo Corp. v. Litton Sys., Inc., 379 F. Supp. 37, 40 (S.D. Miss. 1974)

construction, a hurricane caused damage to the dock. Dravo sent Litton a claim for the cost of the repairs. Litton denied the claim, and Dravo filed in the U.S. District Court in the Southern District of Mississippi. Reviewing the construction contract, the Court found that "the contract executed by and between plaintiffs and defendant is void of any express language placing on either party the risk of damage occasioned by an act of God."[51] It reasoned further:

> The general rule is that where a house is destroyed by fire, and the contractor having agreed to furnish labor and material and construct a completed house for the owner, that he takes the risk of the incompleted house being destroyed by fire, unless he protects himself by expressly contracting that he shall not be held liable for an act of God, or other untoward circumstance, against which he is not willing to be bound.[52]

As there was no express agreement as to who would pay for damage due to the hurricane, Dravo's claim was dismissed. Had Dravo taken out third party builder's risk insurance on the dock it would not have had to pay over $80K in out-of-pocket repairs.

Ways to Improve Builder's Risk Policies and Their Management

Due to the high value of vessels, success in Marine Builder's Risk Insurance litigation is important for Builders, Owners, and Insurers. The current AMIU builder's risk clauses were drafted in 1979. While the policy provides "all risk" coverage, courts have recently found additional exclusions not specifically within the policy, including contractual claims and

[51] Dravo Corp. v. Litton Sys., Inc., 379 F. Supp. 37, 40 (S.D. Miss. 1974)
[52] Ibid.

defective workmanship. Litigation may be prevented if clauses on these sources of loss were written into the builder's risk policy.

Insurers could benefit by maintaining awareness of vessel specifications, and details of how and where they are constructed, including transport during construction. Although they would incur additional drafting expense, the specifications, including detailed material lists – common attachments to shipbuilding contracts – could add greater specificity to what material is covered if added to Builder's Risk Policies, thereby reducing litigation.