Major Projects Association

Strategic Uses of Insurance in Complex Projects. An MPA Seminar held at Willis Ltd, Ten Trinity Square, London in June 2000.

MPA events are confidential. They provide a forum where someone involved in a major project can tell it the way it was. This summary is available to both members and non-members, and care has been taken to ensure that its contents do not breach confidentiality. This account cannot, therefore, do full justice to the event, so members please read the full proceedings when you receive them. Best of all, members, come to the events. Non-members, think about joining!

Participants

More than 50 participants attended the seminar and the following organizations were represented:
Allianz Cornhill International, BAA Plc, Baker & McKenzie, Balfour Beatty Major Projects, Bechtel Ltd, Bovis Lend Lease Ltd, British Energy, British Trade International, Brown & Root Services, CGU Insurance, Chiyoda Europe, Chubb Insurance Company of Europe, CMS Cameron McKenna, Costain Group Plc, Freshfields, George Corderoy & Co, Griffiths & Armour Group, High-Point Rendel, Laing Ltd, Linklaters & Alliance, Masons Solicitors, Miller International, National Air Traffic Services Ltd, National Grid Company, Ove Arup Partnership, PowerGen International, Railtrack, Scott Wilson Group, Scott Wilson Kirkpatrick & Co Ltd, The National Grid Company Plc, Union Railways (South) Ltd, Willis UK Ltd, WS Atkins Plc, Zurich Specialties London Ltd

Over the last few years, there has been consolidation in the insurance industry, resulting in fewer groups with greater financial muscle. With the massive computer power now available, these insurers are in a better position to simulate and assess risk. At the same time, developments in the way that construction projects are owned and managed have led to changing insurance needs. The time is therefore right for a rethink of what the insurance industry can offer major projects—and what project practitioners can do to help make the insurance process run more smoothly.

Insurance is a valuable tool of financial engineering, whether it is in the tradition form of policies, or as alternative risk transfer products which take account of the time value of money or involve the transfer of risk to the capital markets via securitizations, or the use of derivatives and so on.

Cover currently available

For complex construction projects, current cover is available for defects, delay and liability.

Further special categories of risk can also be covered.

Additional cover for environmental risks, especially for the redevelopment of brownfield sites, can be written for site risks, contractors' pollution liability and finite risk and combined policies. The number of major players in this field is increasing and at present numbers ten.

Although weather catastrophe cover has been available with other damage insurance, a new weather risks cover addresses climatic variation, in terms of a warm winter, or an exceptionally wet or dry month. It has a purely financial trigger, for example, loss of revenue through delay caused by adverse weather conditions—for this cover there is no need for damage to have occurred. There is also a growing hedging market (on the Chicago Mercantile Exchange) for weather risk, particularly in the United States.

Trends

Customers are seeking wider cover for projects. There is now a demand for cover for completion risk; revenue risk, particularly for private finance initiative type projects; and maintenance risk. Customers want the best price for cover but they must not lose sight of their need for the insurer to be in business long term. There is no insurance industry protection board for corporate entities.

Some continental countries are experimenting with pools of reinsurance for underwriting environmental risk.

Case study 1 on environmental insurance

A legally contaminated site for an enterprise park

A former steel works, in production for over 100 years, had at the time of its operations a permit to pump a large amount of waste into a deep Coal Measures aquifer. An environmental survey showed the aquifer to be contaminated and to be in contact with a river. The new park on the site of the steel works was to be developed over a 15-year period and there had already been 30 years of dilution, dispersion and bio-degradation. The enforcement authorities felt the risk of harm was low and reducing; and the contamination could not be cost effectively remediated. The business risk was low but the developers and funders were concerned about the finite latent business risk and wanted the long-term financial situation secured. Historical contamination insurance cover of £10 million was provided for a statutory clean-up (should it be deemed necessary after all) and third party claims for 15 years with no breaks for changes in law for a premium of £150,000 in April 2000.

Case study 2 on a claim

Damaged plant for a new combined-cycle gas turbine power station

Three heat recovery steam generators were shipped from the Far East to Europe by sea. In the Bay of Biscay two sections of one, carried on deck, slipped overboard in bad weather and parts in the hold were damaged through poor stowage and salt-water corrosion. The underwriters had taken the right to carry out pre-shipment inspections but had failed to do so. The underwriters then learnt to their surprise that the damaged parts were on the critical path. The problems arose from

- the underwriters not comprehending the critical path programme;
- the insured not appreciating the impact that changes in the construction programme would have on the insurance programme;
- all parties failing to understand the need for more proactive risk management.

The problems were far greater than the damage to the plant would suggest. The contractor has lost his float and any bonus attached and he will probably have to pay for the acceleration of the works, through which he has avoided liability for liquidated damages.

Professional indemnity policies cover a consultant for liabilities which he owes to others as a consequence of negligence. They are not designed to be used as a form of project insurance, as some involved in construction projects have been doing. The construction and insurance industries will need to work together on solutions. But ways forward might be for clients to retain, manage and insure more of their own risk. Or if they are in a partnership arrangement to agree a pain-share ceiling with anything above that being taken on by an insurance company.

Innovative policies are being developed for project risk but few insurers are eager to take it on. Discussions between insurers, clients and financiers indicate that the risks are quantifiable and cover has been extended for a number of projects. However there is a lack of hard data for performing the necessary risk analysis and given the wide range of factors leading to project delay, it will continue to be a challenging area of insurance.

Managing your insurance cover and the claim process

At the planning stage of a major project:

- Be sure you understand the precise cover offered. If necessary seek clarification, and get it in writing.
- Analyse any obligations you have undertaken.
- Treat insurance as a project in its own right. Consider the reporting structures in your project programme and make sure that insurance is part of that process. Think about the contractual relationships that are involved. Decide who will manage the claim and sign the discharge forms.
- It is essential to determine who is in charge of communications and who takes the leading role on the project side and on the insurance side, given the huge number of people involved.
- Set up guidance notes advising on the steps you need to take in making a claim. Make sure that information is kept current, with copies of policies, brief details of contracts, finance, specifications, schedules and timings. Use modern technology to set up a structure and format for loss notification.
- A pre-agreement between the insurers and the insured which should include labour rates, plant rates etc saves time on negotiating claims.

After a loss:

- To use your insurance programme properly, be willing to partner.
- Notify at the earliest opportunity, with caveats if necessary.
- Set target dates and review progress. And in any repair programme set key milestones or get staged agreements, which can trigger funds.

Good basic organization and early planning are the key to a smooth claim.

Case study 3 on insurance for tunnels

The implications of a tunnel collapse for the insurance industry

Although the risk in building the Heathrow Express rail link was not large, it led to a very big claim. The cost of repairs vastly exceeded the actual value of work that had been carried out up to the time of the incident. This is because with a tunnel collapse, both the collapse and the reinstatement of the ground above the tunnel up to the surface have to be indemnified, which increases the cost to the underwriters. Before the Heathrow collapse it had never been felt that tunnels represented a major exposure to large claims. That experience has altered insurance companies' perceptions.