



This article is a continuation of the article on this topic in issue 2/2004 of Risk Consulting. In that article we described risks and risk management and how this and insurance requirements are regulated in standard contract forms. We also informed about the information if P&C needs to be able to offer a well designed insurance solution for the project in question.

Insuring Projects and Contract Work Part 2

Furthermore, the article outlined the insurances that have to be taken out and by whom and it was stressed that this has to be regulated in the contract between the principal and the contractor.

What insurances are required to be taken out for a project?

According to the standard contract forms the contractor is required to take out an All Risk insurance for loss or damage to the project and a Liability insurance for loss or damage caused to a third party.

1. All Risk insurance

The name used for this type of insurance may vary between countries but in the Nordic countries the abbreviations CAR and EAR are often used. These abbreviations are borrowed from the English language and shall be interpreted as Contractors All Risk and Erection All Risk respectively. A CAR insurance is

designed for building and civil works and an EAR insurance for installation and erection of mechanical equipment. In this article we will use the abbreviation CAR/EAR.

As can be understood from the name of these insurances it is an All Risk insurance which indemnifies unforeseen loss or damage to the project without outlining the individual perils to be the cause of the loss or damage. This type of insurance has certain limitations and these are outlined under exclusions in the policy wordings

The structure of a CAR/EAR insurance for a project is as follows:

Insured:

The Contractor if not otherwise stipulated in the Contract.

For large projects where a large number of suppliers and contractors are involved the Principal should consider to take out one insurance for the entire project in order to get a better control

and to eliminate potential gaps between the insurances otherwise taken out by the suppliers and contractors.

Co-Insured:

The Principal

It is essential that the Principal is co-insured in order to have the same rights to claim under the insurance as the Contractor.

Period of Insurance:

The Period of Insurance shall comprise the entire Construction and/or Erection period plus the periods set out in the contract for test and commissioning followed by the contractual Maintenance Period. It is essential that the Period of Insurance corresponds to the time schedule for the project.

Please note that a CAR/EAR insurance issued for a project is in force during the agreed Period of Insurance and if the project suffers a delay of the completion the Period of Insurance must be extended accordingly.

Insured Interest:

All works and supplies according to the contract.

Sums Insured:

The Contract Value and if the project also comprises material and equipment supplied by the Principal its value should be added to the Sum Insured.

Depending on the type of project it can be considered to insure existing property with a relevant sub limit if the project is performed within or in the immediate vicinity of existing installations or buildings. In order to minimise the delay after a loss or damage there should also be a relevant sub limit for expediting expenses. Furthermore there shall always be a sub limit for debris removal and the sub limit to be chosen on basis of possible loss scenarios.

The Contractor shall insure his plant and equipment and the sum insured shall be established on basis of the new replacement value.

Geographical Scope:

The site where the project will be performed.

The Geographical Scope can be extended e.g. for temporary storage of material outside the building site.

Excess/Deductible:

If not stipulated in the contract, the level of deductible is chosen by the



insured i.e. normally the contractor.

The principal shall evaluate the contractor and his financial strength if the chosen deductible is high.

For certain types of projects and activities increased deductibles apply according to the policy wordings. For example underground works and test and commissioning of certain type of plants and installations are subject to increased deductibles.

Policy Wordings:

The Policy Wordings for CAR/EAR insurances are designed to match the distribution of responsibility for loss or damage to the project according to the standard contracts during the construction/erection period as well as during the maintenance period. If alterations and/or amendments have been made to the standard contracts it is essential review and discuss these changes with the broker and/or If P&C in order to make necessary changes to the Policy Wordings well ahead of the start of the project.

It is essential to keep in mind that a CAR/EAR insurance only covers physical loss or damage to the project. Contracted project properties such as quality,

capacity and performance are to be regarded as commercial risks and cannot be insured.

In every CAR/EAR Policy Wordings there is fundamental exclusion of loss or damage due to faulty design, faulty material and faulty workmanship. These risks shall be carried by the responsible contractual partner. In If P&C's Policy Wordings this exclusion is limited to the costs which would have incurred to repair, replace or rectify the original defect if such defect had been discovered before the occurrence of loss or damage.

Safety Regulations:

Safety Regulations are included in every CAR/EAR Policy Wordings and have been developed on basis of If P&C's long claims experience.

Good knowledge and understanding of the Safety Regulations is in our opinion an essential part of the loss prevention program and furthermore established routines shall be in place to make sure that the regulations are adhered to by everyone active on site. The most important regulations are the rules for hot works and for theft and burglary on site. In case of a loss or damage and it is proven that it was caused or worsened

by a breach of the Safety Regulations it will lead to a reduction of the indemnity to be paid under the policy or in certain cases indemnity will be declined in full.

2. Liability Insurance

During the performance of a project there is always an exposure for loss or damage to a third party, person and/or property. It is therefore essential to stipulate in the contract that the Contractor shall have a Liability Insurance in force and tailored to match his activities. It shall be in force for the entire project period including the maintenance period and the sum insured shall be satisfactory. In some of the standard contracts it is stipulated a minimum sum insured for the Contractor's Liability insurance.

The exposure to a third party varies substantially between different types of projects. The exposure during the installation of a machine inside an existing plant is normally limited. On the other hand, rock blasting or piling in the middle of a city or close to installations sensible to vibrations may create substantial exposures to third party both with respect to persons and property. For such projects it can be relevant to demand a higher sum insured than stipulated in the standard contract. If the exposure is large or difficult to estimate we recommend consulting our liability experts for a discussion about the adequate sum insured for the project in question. It shall be kept in mind that it is always the insured that is responsible for choosing the sum insured.

The latter type of projects requires a careful Risk Analysis and a well designed Loss Prevention Programme and this is normally a prerequisite if If P&C shall be able to provide a Liability Insurance.

Certain types of projects generate potential environmental disturbances or are performed in sensitive environments and methods of working and the material used must be carefully chosen.

When performing certain projects it is sometimes inevitable that a third party suffers inconveniences or even costs or loss of revenues. Such foreseeable inconveniences can never be insured under a liability insurance.

A well designed environment protection plan is under such circumstances an essential part of the contract with a clear distribution of responsibilities and with observance of applicable laws and regulations. For the project such a plan is normally a prerequisite to get the neces-

sary approvals and permits from the authorities.

3. All Risk and Liability Insurance

Many of the appointed suppliers and contractors will refer to their annual insurance policies which cover all the projects they perform during the period of insurance. It is then necessary for the Principal to request certificates of insurance and carefully check that the sums insured and the extent of cover are adequate and in accordance with the contractual requirements as outlined above. It is also important for the Principal to continuously follow up that these annual policies are renewed and request new certificates of insurance.

4. Delay in Start Up – DSU Insurance

The objective with an investment is normally to supply the enterprise with new and improved production capacity in order to increase the contribution from the production. We have stated above that a CAR/EAR insurance only covers physical loss or damage and that the commercial risks have to be carried by the parties.

Anyhow, there is one type of insurance Delay in Start Up which the Principal can take out and the interest then insured is the budgeted contribution from the project when taken into commercial operation. The prerequisite for indemnity is that the project shall have suffered a delay of the start up of the commercial operation due to a valid loss or damage under the CAR/EAR insurance. As it is essential for If P&C to control the physical damage to the project as well as the loss of contribution, the Principal must take out both the CAR/EAR and the DSU insurance with If P&C.

The sum insured for a DSU insurance is established on basis of the estimated time for repair and replacement if the project suffers a loss or damage. The time to be considered is the time needed to manufacture lost or damaged machines or parts thereof or the time needed to rebuild the building or sections thereof and these estimates are to be based on a worst case scenario. The time needed according to this Risk Analysis gives the relevant indemnity period to choose for the DSU insurance. The sum insured is then calculated as the contribution the project should have generated according to the budget for this period.

Regarding Risk Management and

Loss Prevention it is of importance to especially scrutinise the activities on the critical line according to the time schedule for the project. It may be supply of material or equipment, building or erection activities and by identifying these, an alteration of the time schedule could be considered with respect to critical supplies or the methods of working. The suppliers and contractors skills and experience of the actual type of project are as well of crucial importance for a successful project i.e. ready on time and with properties and capacity according to the contract.

It shall be noticed that it is difficult to get DSU cover for prototypes or for totally new products in the market as it is difficult to judge if the budgeted contribution is realistic.

We have in connection with larger projects noticed that it is becoming more common that banks and financiers demand that a DSU insurance is taken out and this in order to get a guarantee that the Principal can fulfil his obligations under the loan agreements.

Summary

Our intention with this and the article in the previous issue of Risk Consulting has been to draw attention to such facts and risk exposures that according to our experience as insurer are essential to deal with in a professional way in order to be able to perform a project on time and with the intended end product. Furthermore we have informed about how risks that cannot be eliminated with a carefully designed Loss Prevention programme can be insured. We have also stressed the importance of having If P&C's experts involved as early as possible to allow for our experience and knowledge to be utilised in the best possible way. We have also stressed that the prerequisite for a well designed insurance cover at a reasonable premium is that If P&C at an early stage gets access to information about the project to the extent as outlined in the previous article. •



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