Aon Risk Solutions
Global Construction & Infrastructure

Commercial Operations Date vs. Completion: A Regular Case of Mismatch and Misunderstanding

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Would it surprise anyone reading this item to discover (or perhaps “fully appreciate” is a better term) that the insurance industry has not kept pace with either Employer’s or Lender’s requirements in construction contracts relating to both the commencement and expiration of engineering insurances such as Builder’s All Risk (BAR), Contractor’s All Risk (CAR), Erection All Risk (EAR) and Construction & Erection All Risk (CEAR)?

The primary reason for concern is due to the longer project timelines of large projects. The insurance market is regularly being tested on the length of coverage it can quote at the outset. This means that a full understanding of the dates for commencement and expiration make a significant difference to the capacity that any insurer is able to deploy on any given risk and therefore on the competitive pricing tensions as certain insurers and/or reinsurers may not be able to be a part of the panel for projects requiring coverage for a period greater than X months.

Finance agreements and Engineering, Procurement and Construction (EPC)/Turnkey construction contracts often require insurance coverage inception at Financial Close or Notice to Proceed, whereas many forms of engineering insurance policies do not begin until work at the site has commenced or even until after the unloading of materials and/or equipment for incorporation into the Works (presumably on a per item basis which is in and of itself, something of an ambiguity).

This may seem almost inconsequential but may not be depending upon the circumstances of the project and the detail into which the Lenders and their legal advisors delve. When considered alongside ‘standard’ maintenance period cover clauses, which refer to liability being triggered only for incidents caused during the construction period or insurance period, however, there can be negative ramifications resulting from a less than fully informed view of these matters at a very late stage in a project’s life cycle.

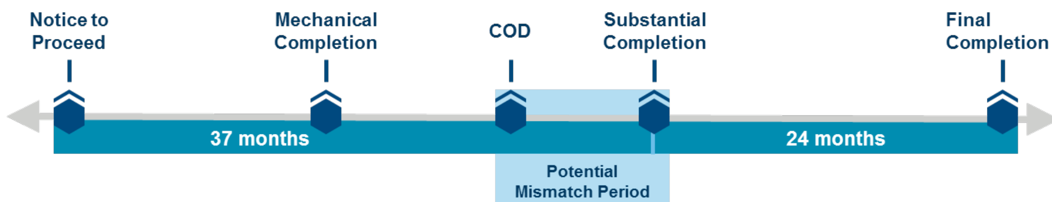
However, far more important in our view is the potential mismatch regarding insurance policy expiry and Completion, as defined by the various project agreements.

Most construction underwriters aim to have their policies cease once the risk is able to operate and achieve Commercial Operations Date (COD). Part of their desire for this is they can then issue operational policies which exclude some parties previously insured during the construction phase and thus ensure that insurers have rights of subrogation against those parties, primarily, the EPC or Turnkey contractor and major Original Equipment Manufacturers (OEMs).

This may resonate and align with a Concession Agreement or Power Purchase Agreement (PPA)-type contractual structure on the one hand, because these agreements often allow commercial revenue generation at the earliest possible point in time so as to facilitate usage of the project by the public, whether it be a hospital, power station or road, to name a few.

To ensure that the Owner/Employer, who has the liability for the availability and efficiency risks, and therefore wishes to receive a project of unquestioned and evidenced quality, many modern construction contracts demand a more stringent process for reaching a point where they will accept risk of loss back from the EPC Contractor and thus require the contractor to perform numerous more tasks than simply helping achieve commercial revenue generation before a form of ‘completion’ is awarded to the contractor and risk of loss reverts back to the Owner/Employer.

Indeed, terms such as “COD” are rarely found in construction contracts. A recent example from a project where Aon is the broker involves a contract where the contractor is required to provide confirmation of the successful finalisation of more than twenty (20) items in addition to completing a testing regime that would allow COD.



Therefore, the issue is essentially about a disparity in risk allocation in the main contracts that create and drive projects and especially in Public-Private Partnership (PPP), Build-Operate-Transfer (BOT), Build-Own-Operate-Transfer (BOOT), Build-Own-Operate (BOO)-type deals where greater lifecycle risk remains with the private sector stakeholders even during operation.

This can lead to a situation in which:

- COD has been awarded under a Concession-type agreement and therefore commercial revenue is being generated,
- So the construction period insurers are looking to come off risk,
- But the EPC Contractor still has risk of loss (for at least a part of the project) which, contractually, is still considered as being under construction,
- And the Owner has agreed within the construction contract to maintain insurance on behalf of the contractor until ‘completion’ however defined, in the construction contract.
- Plus there are also situations in which through this initial period (i.e. until the Contractor has demonstrated that the project can meet the performance criteria required by the EPC Contract (which may have some differences to the Owner’s agreement with their Client)), it is the EPC Contractor who operates the plant.

Therefore, it is essential that your construction risk and insurance advisor is fully versed in the contractual terms, clauses and nuances of all the project agreements (i.e. not just the construction contract) and is able to engineer an insurance solution that both meets the contractual requirements that the Owner has agreed to and leaves no stakeholder exposed to an uninsured loss (which could result in legal action against the Owner and perhaps result in an Event of Default under the loan agreement.

Contacts

Gary Swinfield
Regional Director
Construction, Power & Infrastructure
Aon Risk Solutions - Singapore
+65.6231.6315
gary.swinfield@aon.com

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