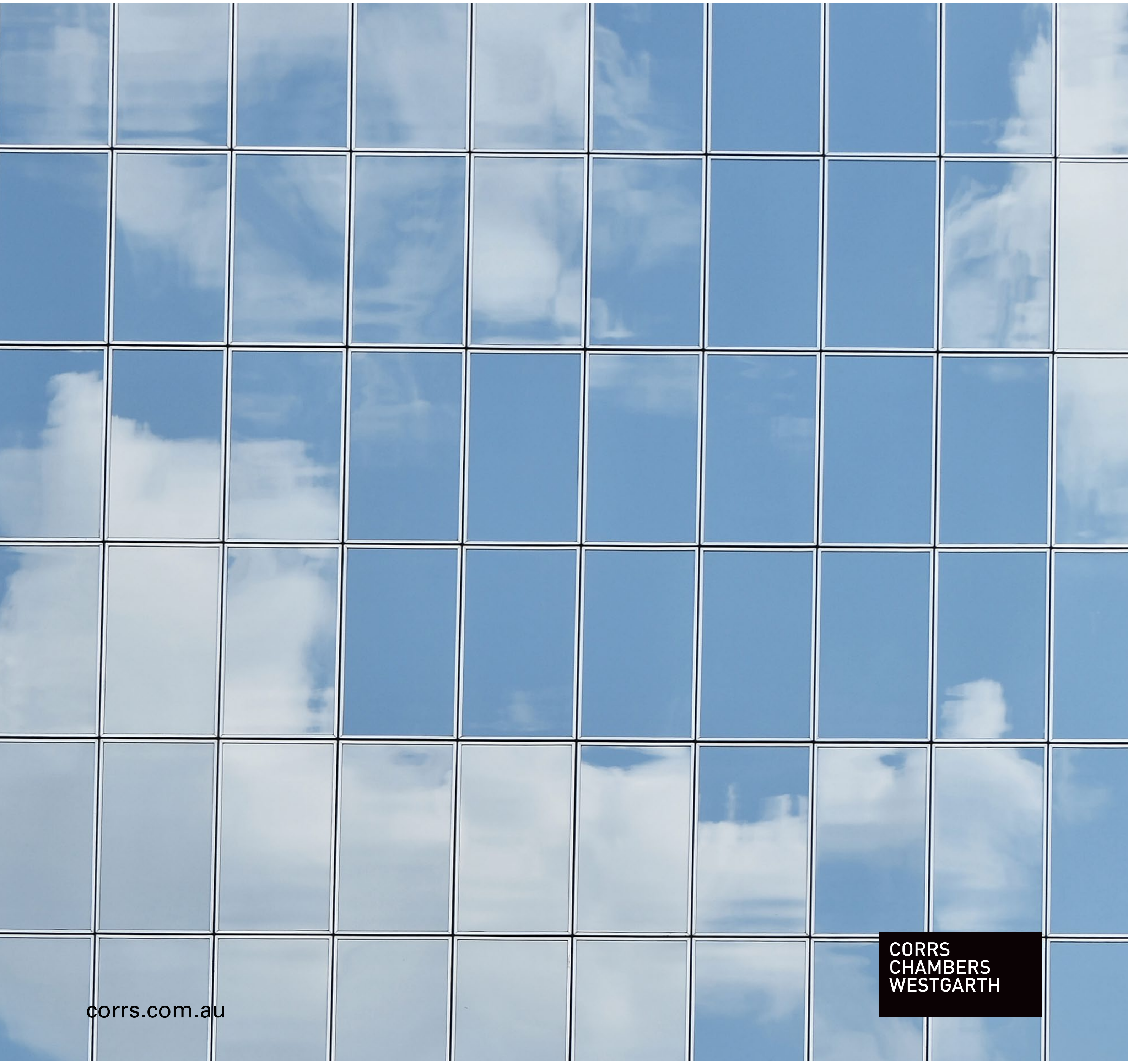
COVID-19: Changing the way we think about project insurance

White Paper

September 2021



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Introduction

The world will not be the same again, or at least not the same again in the short to medium term. The COVID-19 pandemic has introduced an event which has caused massive dislocation to ordinary business activities and, notwithstanding government assistance, has caused massive loss to the private sector directly or indirectly.

Insurance is often seen as a mitigant for the occurrence of risk events. The insurance sector is not well-placed to accommodate a risk which is neither predictable or applicable to specific geographies or events (**Systemic Risks**). Against Systemic Risks, insurers' reliance upon socialising a predictable cost over insureds who each make a contribution is not applicable. All or very many are affected. The COVID-19 pandemic is the realisation of such a risk.

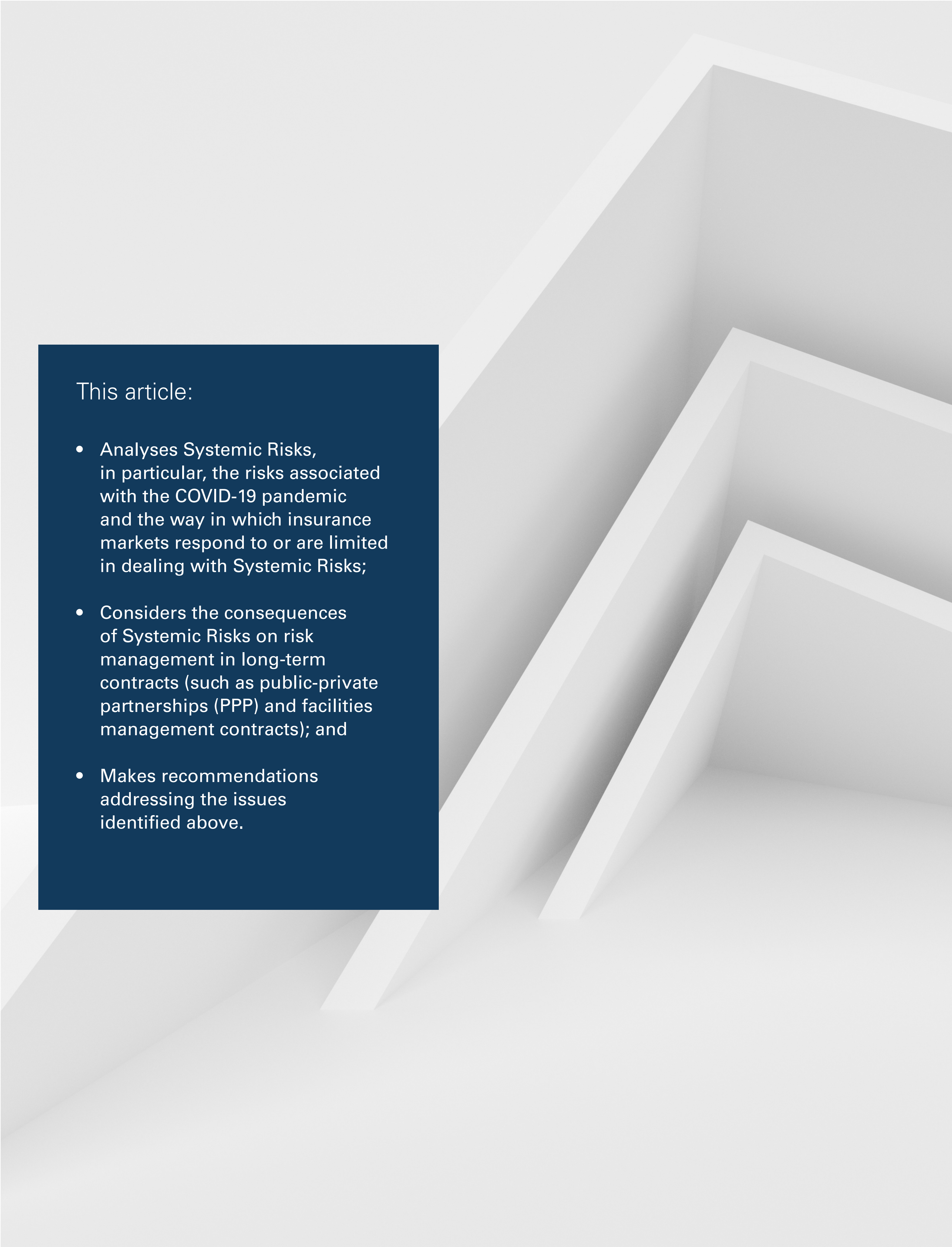
These risks have manifested themselves in the past. Terrorism coverage became difficult to obtain and, if obtainable, came at significant and increased cost. Similar issues have arisen for the insurance coverage available in the insurance market for business interruption insurance, in particular, resulting in the exclusion or limiting of coverage.

As might be expected, the occurrence of the COVID-19 pandemic has given rise to insurers seeking to contest or test the terms of particular insurance policies. This paper discusses some of those issues and the approach which the courts have adopted.

Further, in existing large-scale projects in the operational phase which proceed on the basis that insurance will be forthcoming for a wide spectrum of business interruption events, the existing contractual documents may not respond appropriately. The concept of uninsurable risks for which there is a separate regime under many of these contracts does not readily accommodate a situation where, for example, insurance may be available but at prohibitive cost.

For existing projects, an analysis of the specific contractual terms and the insurances required in the context of the insurance market from time to time point a way to a flexible solution being tailored to the circumstances. For existing projects and, more generally, for future projects, it may be necessary to develop an insurance or risk mitigation program similar to that which has been adopted for terrorism coverage where a measure of government support has facilitated the provision of appropriate risk coverage.

While the specific risk which has manifested itself is the COVID-19 pandemic, other events could be just as disruptive to business activity, creating the same limitations on insurance as a risk mitigant. These issues are already apparent in the insurance market. Coverage for climate change related risks is already presenting difficulties.



This article:

- Analyses Systemic Risks, in particular, the risks associated with the COVID-19 pandemic and the way in which insurance markets respond to or are limited in dealing with Systemic Risks;

- Considers the consequences of Systemic Risks on risk management in long-term contracts (such as public-private partnerships (PPP) and facilities management contracts); and

- Makes recommendations addressing the issues identified above.

02

The role of insurance in long-term contracts

Insurance coverage for the construction phase of projects is obtained over a short timeframe. The insurance is arranged usually for the whole of the construction period. As a result, the available insurance coverage and the allocation of risk between the parties is known at the outset.

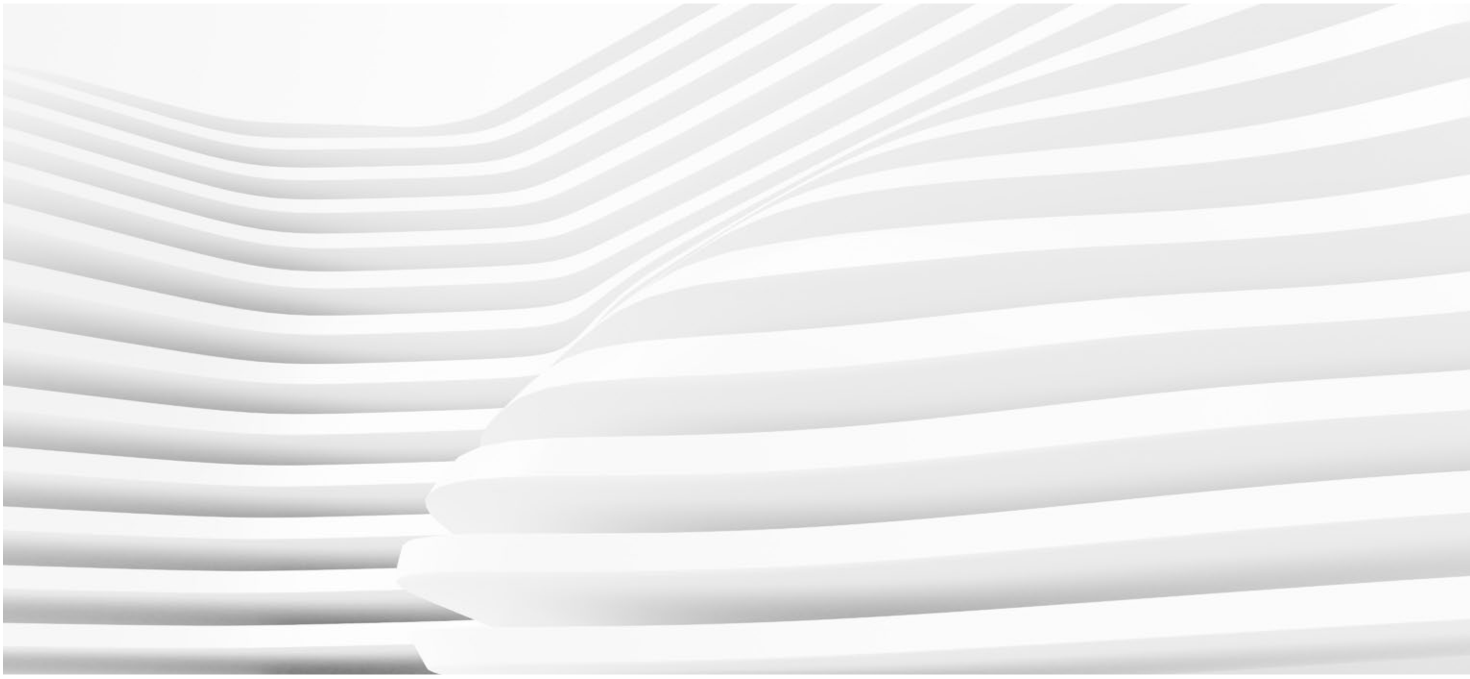
This is to be distinguished from the operational phase of projects where the risk allocation is typically fixed and the insurance coverage is specified. The insurance coverage requires renewal (usually annually) and is subject to the availability and costing of insurance at the time of renewal. This paper analyses the interaction between risk allocation and insurance in respect of the operational phase of long-term contractual arrangements.

Typically, obligations will be imposed upon a party to obtain insurance on minimum terms. In long-term contracts, especially those relating to facilities or hard assets, the identification of risks – and insurance against those risks – presents issues.

First, the risks may be specified at inception but the nature of the risks may change over time (e.g. extreme weather risk due to the effects of climate change). Secondly, the availability and economic cost of insurance against particular risks may change over time (e.g. insurance for pandemic risk).

A PPP contract is a particular manifestation of a long-term contract, usually involving hard assets where risks are laboriously yet still imperfectly identified and allocated. Whilst insurance is an integral consideration in discussing risk allocation, the purpose of insurance tends to be misconceived as a substitute for risk allocation and is generally not properly integrated in the drafting of the entire contract.

Each of the principal, the private sector proponent and the private sector proponent's financiers, will have a vested interest in ensuring that risk which is allocated to each of them is adequately insured. However, contrary to common expectations, it is only a certain subset of risks which are insurable. Most risk allocation under a long-term contract is not a matter of insurance. For example, operational risk may be allocated to an operator and if the operator does not perform the operator is not paid (and if the service is not delivered then the State generally has no obligation to make payment). Some of the events such as fire or third party damage which cause the service not to be delivered may be insured.



03

Systemic Risks: the emerging and unconsidered danger

In the context of a hardening insurance market, the economic disruption caused by the consequences of the COVID-19 pandemic has brought insurance issues to the forefront. Insurers' response to those risks is unsurprising in light of their initial response to other unprecedented events, such as the events of 11 September 2001.

Systemic Risks such as pandemic risk are risks relating to events that are difficult to predict and evaluate because of the potential for indiscriminate and broad-scale impact, the consequences of which may endure beyond a single occurrence.

Other examples of Systemic Risks that have the potential to materially affect long-term contracts include prolonged extreme weather events due to climate change (noting that extreme weather has been identified as the 'top global risk by likelihood' in the surveys conducted for the World Economic Forum's Global Risks Report since 2017) and debt crises in large economies.[1]

Systemic Risks are uncertain and might manifest quickly and unexpectedly. Notably, until the publication of the World Economic Forum's Global Risks Report in 2021, pandemic risk had not been identified within the top five 'top global risks by likelihood' (in the reports published since 2012).

Long-term contracts are particularly susceptible to Systemic Risks, given the term of the contract typically extends across decades and insurance is required throughout the term.

A Systemic Risk has the potential to materially adversely affect insurance markets due to either or a combination of a sudden influx of claims and reduction in investment income. The effect of a Systemic Risk on insurance markets becomes apparent upon the renewal phase of an existing insurance program or when parties turn to their insurance policies to seek to mitigate losses arising from disruption to their business.

The rights, obligations and procedures recorded in a contract are unlikely to provide a solution for dealing with the challenges presented by the unavailability of insurance, particularly where it is apparent that insurance for certain risks will be unavailable over a prolonged period of time. The contract may not reveal a practical way forward for parties to deal with emerging gaps in their insurance program. As a result, the parties have little alternative but to deal with the consequences of insurance being unavailable.

1 In describing 'debt crises in large economies', we adopt the concept used in the World Economic Forum's Global Risks Report in 2021.

03

The state of insurance markets and the effect of COVID-19 pandemic risks

The year 2020 unarguably was the peak of uncertainty due to the consequences of the COVID-19 pandemic as the global community navigated through the implications.

Generally speaking, a primary means by which insurers generate revenue is through receipt of premiums and reinvesting that income.

Statistics published quarterly by the Australian Prudential Regulation Authority (**APRA**) suggest that those effects were felt within insurance markets.

In the year ended 30 June 2020, Australian general insurers reported a:

- net profit after tax of $1 billion (compared to $3.5 billion for the year ended 30 June 2019);
- return on net assets of 3.7% (compared to 12.4% for the year ended 30 June 2019);[2] and
- investment income of $1.4 billion (compared to $3.6 billion for the year ended 30 June 2019).

According to the APRA this was attributable to lower underwriting results[3] from natural disaster events and a decrease in investment income due to the consequences of the COVID-19 pandemic in the March 2020 quarter. Insurers also reported increases in gross earned premium[4] in various classes of insurance, including industrial special risk and professional indemnity insurance.

In the year ended 31 December 2020, Australian general insurers reported:

- a net profit after tax of $35 million (compared to $3.1 billion for the year ended 31 December 2019);
- return on net assets of 0.1% (compared to 11.4% for the year ended 31 December 2019); and
- investment income of $1.7 billion (compared to $3.4 billion for the year ended 31 December 2019).

According APRA, this was driven by natural catastrophe claims costs, provisions for business interruption claims, and decrease in investment income. Insurers also reported increases in gross earned premium in various classes of insurance, including industrial special risk and professional indemnity insurance.

In respect of the reporting periods specified above, it could be drawn from the statistics reported by APRA that the:

- increase in premiums; and
- significant decrease in insurers' investment income,

was, at the least, partially driven by the economic impact of the COVID-19 pandemic.

Therefore, it appears that the consequences of the COVID-19 pandemic significantly exacerbated what was already a hardening insurance market. Although gross earned premiums increased, investment income had certainly decreased and it is doubtful that the premium increases were sufficient to wholly offset insurers' investment losses.[5]

2 Net profit/loss divided by the average net assets for the period (per APRA Glossary).

3 Net premium revenue less net incurred claims and underwriting expenses (per APRA Glossary).

4 The earned premium revenue relating to direct business and inwards reinsurance plus Fire service levy and measured on an AASB 1023 basis (per APRA Glossary).

5 There is indication of stabilisation. According to the APRA Quarterly general insurance performance statistics – highlights March 2021 (released 27 May 2021), the industry reported a net profit after tax of $19 million in the March quarter, which is a significant improvement from the results of the December quarter being a net loss after tax of $622 million predominantly due to increased provisions for COVID-19 related business interruption claims.

04

The COVID-19 pandemic and business interruption insurance

The COVID-19 pandemic has given rise to many claims on business interruption insurance policies. As is to be expected, both the insurer and insureds have deeply considered the terms of those policies.

Business interruption insurance policies cover a wide spectrum of risk and are designed to provide coverage for revenue which has been lost by an insured because of the occurrence of the insured risk. Often, business interruption insurance policies require some other insured event to have occurred before a claim may be made for the loss of revenue. For example, some damage or other event must have occurred to the insured’s asset or business before a claim for business interruption coverage may be made.

In Australia and the United Kingdom (**UK**), test cases have been brought before the courts in relation to COVID-19 business interruption claims.

05

Business interruption insurance: UK test case

In *The Financial Conduct Authority v Arch Insurance (UK) Ltd and* others [2021] UKSC 1 (**FCA Decision**) the UK Supreme Court was asked to consider (amongst other issues) the proper interpretation of forms of:

- disease clauses, which generally provide cover for business interruption losses resulting from the occurrence of a notifiable disease (**Disease Clauses**);
- prevention of access clauses, which generally provide cover for business interruption losses resulting from public authority intervention preventing or hindering access to, or use of, the business premises (**POA Clauses**);
- hybrid clauses, which combine the main elements of the Disease Clauses and POA Clauses (**Hybrid Clauses**); and
- trends clauses, which are used in business interruption insurance to quantify the insureds' financial loss and operate by taking a period of trading prior to the occurrence of the insured risk and then comparing that figure to the actual revenue during the period of insurance. Trends Clauses provide for any adjustments to reflect the specific circumstances of the insured's business to seek to generate an accurate figure for the insured loss (**Trends Clauses**).

Some of the UK Supreme Court's findings on the interpretation of the sample clauses are set out below.

The decision is not binding authority on Australian Courts but it may influence the interpretation of similarly worded policies. More generally, the litigation before the UK Supreme Court indicates the scrutiny which both the insured and insurer place upon specific contractual wording and the rather arbitrary outcome of the application of the wording in the relevant insurance policy.

A.

RSA 3 – Sample Disease Clause

'We shall indemnify You in respect of interruption or interference with the Business during the Indemnity Period following…any…occurrence of a Notifiable Disease within a radius of 25 miles of the Premises…'

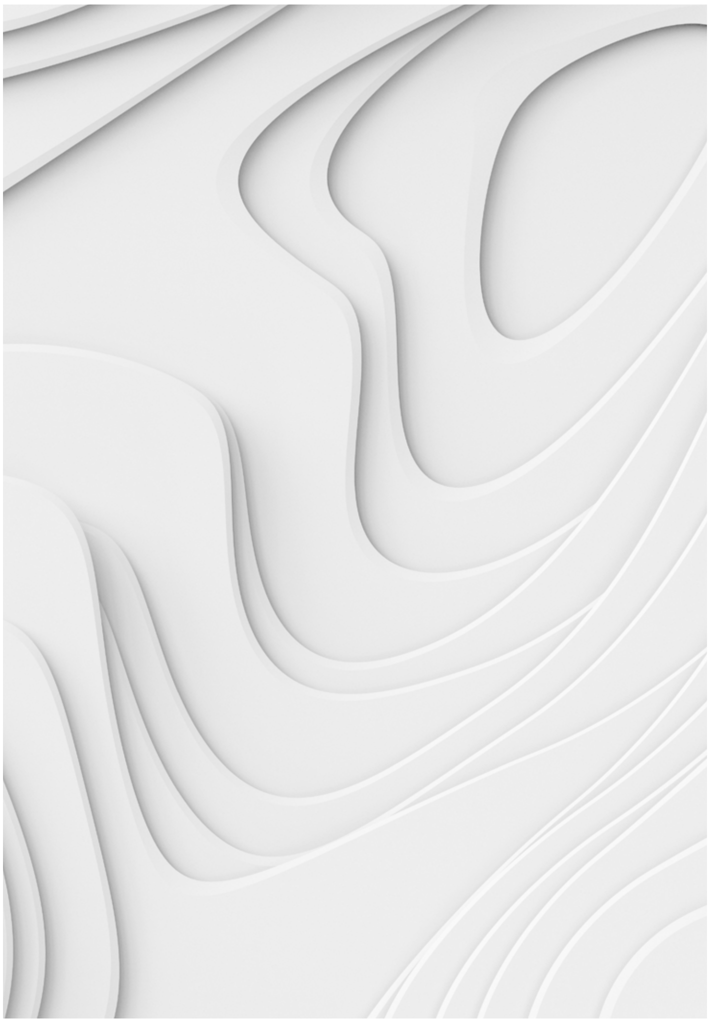
What is meant by the words of the insuring clause: 'any… occurrence of a Notifiable Disease within a radius of 25 miles of the Premises' and what is the scope of the peril insured against by this provision?

The insuring clause is properly interpreted as providing cover for business interruption caused by any cases of illness resulting from COVID-19 that occur **within** a radius of 25 miles of the premises from which the business is carried on. In particular, each case of illness sustained by an individual at a particular time and place is a separate occurrence (and not the fact of the outbreak of a disease).

Contrary to the insurers' argument, the business interruption as a consequence does not need to be solely derived from a case of illness within the 25 mile radius.

The result of this interpretation is that, provided that a cause of the business interruption includes a case of illness within the specified radius of the premises, even if the business interruption was due to multiple causes, there is insurance coverage.

The interpretation of policy wordings in relation to the proximity of an outbreak to a business is being considered in an Australian test case. This decision may be relevant to those proceedings.



B. Arch – Sample POA Clause

'...loss ... resulting from ... Prevention of access to the Premises due to the actions or advice of a government or local authority due to an emergency which is likely to endanger life or property.'

Whether only the total (as opposed to partial) closure of premises for the purposes of an existing business could qualify as 'prevention' or 'denial' of access to the premises.

Prevention of access may include prevention of access to a discrete part of the premises or to the whole or part of the premises for the purpose of carrying on a discrete part of the policyholder's business activities.

C. Hiscox 1-4 – Sample Hybrid Clause

'losses resulting solely and directly from an interruption to your activities caused by your inability to use the insured premises due to restrictions imposed by a public authority during the period of insurance following an occurrence of any human infectious or human contagious disease, an outbreak of which must be notified to the local authority.'

Whether 'restrictions imposed' means something which is both expressed in mandatory terms and has the force of law.

Restrictions imposed' by a public authority would be understood as ordinarily meaning mandatory measures 'imposed' by the authority pursuant to its statutory or other legal powers but a restriction need not always have the force of law before it can fall within this description (such as where a mandatory instruction is made with legally binding measures to follow).

Whether the 'restrictions imposed' necessarily had to be directed to the policyholder or to its use of the insured premises.

The words 'restrictions imposed' are general and unqualified. Concurring with the UK High Court, in most cases the relevant restrictions would be directed at the insured premises or the use of the premises by the policyholder, but they are not required to be so.

Whether an 'inability to use' the business premises due to restrictions must be a complete inability to use the premises.

'Inability to use' would include where the policyholder is unable to use the premises for a discrete part of its business activities or if it is unable to use a discrete part of its premises for its business activities.

Whether 'interruption' means a complete cessation of the policyholder's business or activities.

The ordinary meaning of 'interruption' includes interference or disruption which does not bring about a complete cessation of business or activities.

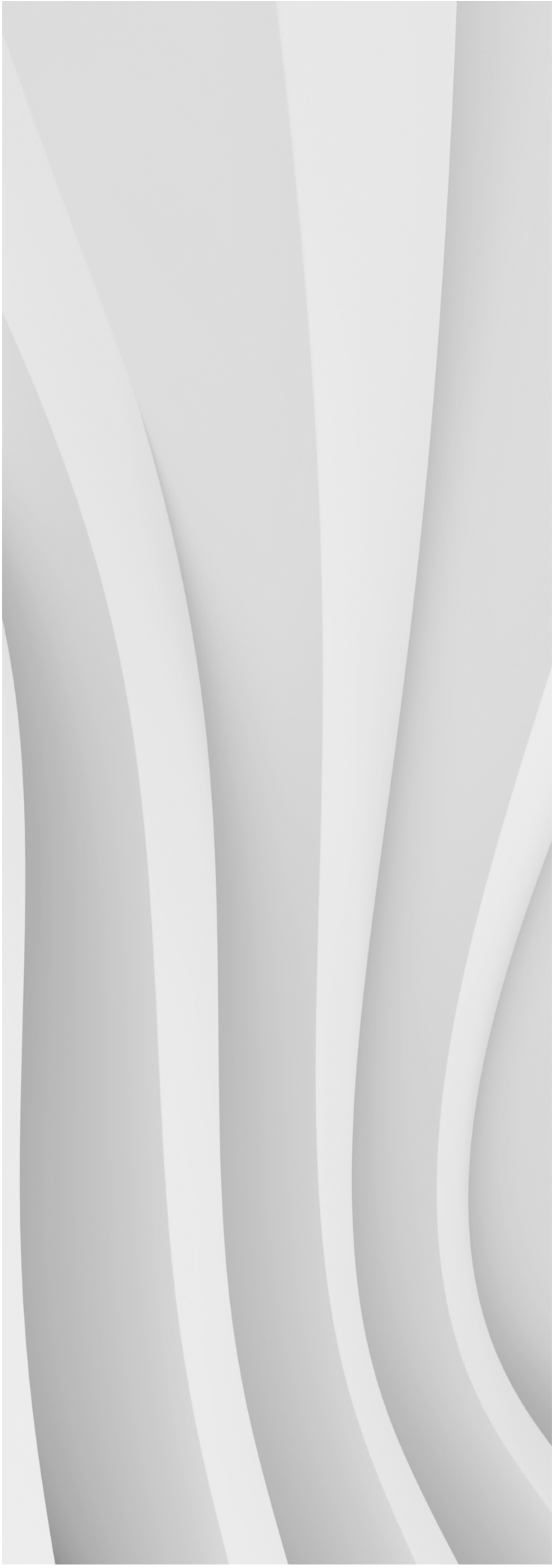
D. Hiscox 3 – Sample Trends Clause

'The amount we pay for loss of gross profit will be amended to reflect any special circumstances or business trends affecting your business, either before or after the loss, in order that the amount paid reflects as near as possible, the result that would have been achieved if the damage had not occurred.'

Whether Trends Clauses should be interpreted as requiring insurers to indemnify policyholders for losses which would have arisen regardless of the operation of the insured perils, by reason of the wider consequences of the COVID-19 pandemic.

The UK Supreme Court emphasised the following matters in interpreting Trends Clauses:

- Trends Clauses should, if possible, be construed consistently with the insuring clauses in the policy so as not to take away the cover provided by the insuring clauses; and
- absent clear wording to the contrary, Trends Clauses should be interpreted by recognising that the aim of such clauses is to arrive at the results that would have been achieved but for the insured peril and circumstances arising out of the same underlying or originating cause. Therefore, the trends or circumstances referred to in the clause for which adjustments are to be made should generally be construed as meaning trends or circumstances unrelated in that way to the insured peril.



06

Business interruption insurance: Australian test cases

To highlight, the issues caused by the different perspectives of the insurer and insured of precise policy wording arose in *HDI Global Specialty SE v Wonkana No 3 Pty Ltd* [2020] NSWCA 296. The primary issue for determination was whether the reference to 'diseases declared to be quarantinable diseases under the *Quarantine Act 1908* (Cth) and subsequent amendments' should be construed as extending to 'diseases determined to be listed human diseases under the *Biosecurity Act 2015* (Cth)' (**Biosecurity Act**). If so, claims in relation to risks associated with the COVID-19 pandemic under the insurers' respective business interruption insurance policies would not be insured.

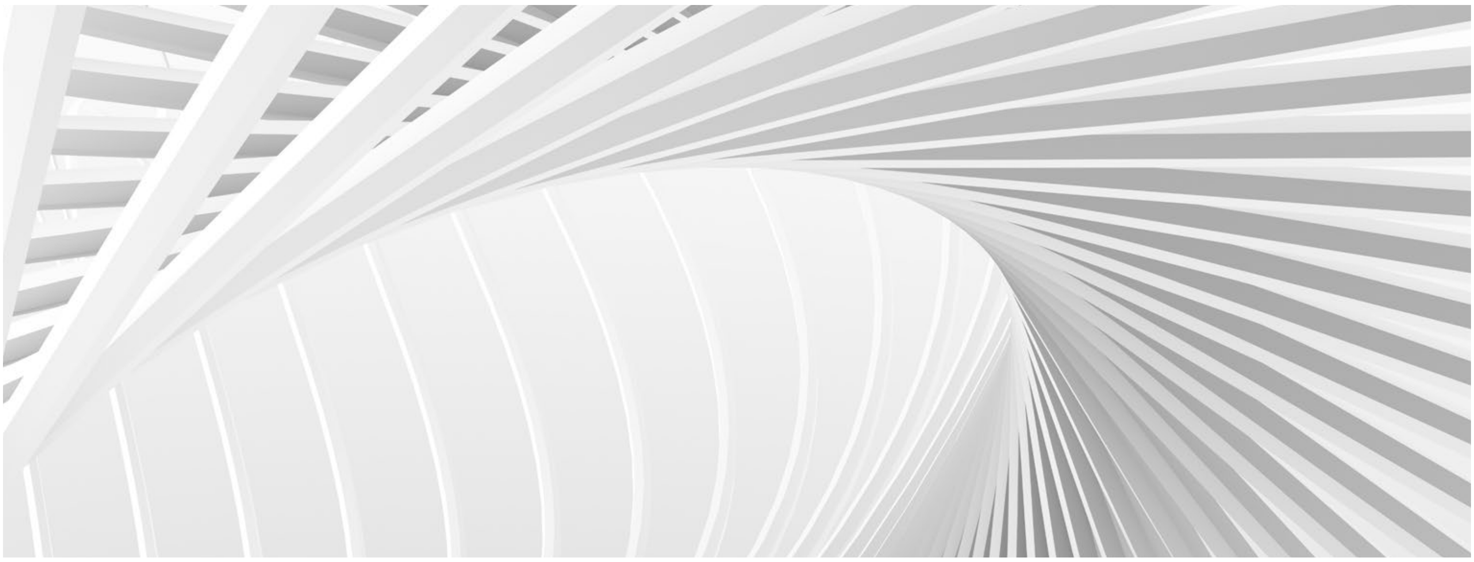
The *Quarantine Act 1908* (Cth) was repealed on 16 June 2016 and replaced with the Biosecurity Act. The Court found against the interpretation submitted by the insurers with the result that the insured's business interruption claim was not subject to the exclusion.

An application for special leave to appeal the decision in the High Court was dismissed and therefore, the decision of the New South Wales Court of Appeal remains good law.

This decision will affect existing claims under similarly worded business interruption insurance policies. To the extent precedent business interruption policies in Australia contain a disease exclusion referring to the *Quarantine Act 1908* (Cth) and its subsequent amendments, insurers would be seeking to correct those references in light of the Court's findings.

The Insurance Council of Australia has also announced the commencement of a second business interruption test case in the Federal Court of Australia against various major Australian insurers. The proceeding concerns several claims made by small businesses referred to the Australian Financial Complaints Authority's dispute resolution process.

The test case will determine the proper interpretation of policy wordings in relation to the definition of a disease, proximity of an outbreak to a business, prevention of access to premises due to a government mandate and policies that contain a hybrid of these type of wordings. We expect that this test case will refer to the approach adopted by the Court in the FCA Decision, although there may be differences in the exact drafting of the clauses considered in each case.



07

Managing uninsured risks

Insurance markets are reactive in dealing with Systemic Risks.

The events of 11 September 2001 exposed terrorism as a significant threat and caused insurers to reconsider and adjust their underwriting policies.[6] Initially, this resulted in insurers withdrawing coverage for terrorism (and, even if insurance were available, it was not available on commercially reasonable terms).[7] Once insurers were able to properly evaluate terrorism risk, insurance became available albeit on limited terms.

In Australia, the economic impact and uncertainty caused by the unavailability of insurance for terrorism risk was recognised by the government and the *Terrorism Insurance Act 2003* (Cth) (**Terrorism Insurance Act**) was introduced to seek to address those issues. The Terrorism Insurance Act negates a terrorism exclusion in an 'eligible insurance contract' in relation to an eligible terrorism loss or liability and established the Australian Reinsurance Pool Corporation to provide reinsurance coverage for terrorism.

It is apparent that insurers perceive the COVID-19 pandemic generates significant risks and are taking steps to seek to mitigate their exposure. We have seen that, on renewal of an insurance program, insurers are pre-emptively applying broad exclusions to pandemic-related triggers and are taking a more conservative approach in reviewing the terms of existing policies. This may be the status-quo until legislative intervention or insurers have determined the general parameters within which they would be willing to insure pandemic risk (as was the case with terrorism risk).

A consequence is that certain risks which were previously insurable may either be no longer insurable or are insurable but not on commercially reasonable terms.

This is problematic for projects administered under long-term contracts which require a party to obtain insurance on minimum terms for the life of the project. The insurance obligations may have been drafted having regard to the insurance available and the nature of the insurance market at the time of contracting.

The first point of enquiry is whether the contract stipulates a procedure to be followed or a mechanism to deal with any uninsured risk. For example, the Victorian Department of Treasury and Finance's standard form PPP Project Deed (**Standard Form Project Deed**) has a mechanism to deal with 'Uninsurable' risks. 'Uninsurable' risk is defined as:

> '… a risk that is required to be insured under this Deed and is insurable at the date of this Deed, but during the Term:
>
> a. insurance becomes unavailable in the recognised international insurance market from Reputable Insurers in respect of that risk; or
>
> b. the insurance premium required to be paid to insure that risk with a Reputable Insurer, or the available terms and conditions of the relevant insurance, are such that the risk is no longer generally insured against in Australia or the United Kingdom by private sector providers of infrastructure similar to the Project Assets or activities similar to the Project Activities,
>
> provided that the conditions referred to in paragraphs (a) and (b) have not come about due to any Project Co Act or Omission.'

If a risk is 'Uninsurable' then that risk is not required to be insured for so long as that risk remains 'Uninsurable'. The parties are required to meet to discuss the means by which the risk should be managed.

If a risk is found to be 'Uninsurable' and consequently not insured against, the question arises as to the allocation of risk upon the realisation of that risk. It is to be observed that risk may best be allocated to the party with the greatest interest in the continuation of the project, often the principal or long-term offtake party. The Standard Form Project Deed provides mechanisms to deal with 'Uninsurable' risk which is supported by an indemnity from the State.

6 Soeffker Anne, 'The insurability of terrorism risk after September 11 2011' (2005) 16 *Insurance Law Journal*.

7 Explanatory memorandum, *Terrorism Insurance Bill 2002* (Cth).

Case Study – State PPP Project – Part A[8]

A State PPP Project between the State and Project Co involves the operation, maintenance and repair of substantial assets over an extended concession period. The State PPP Project has been in its operations and maintenance phase for several years.

The Project Deed for the State PPP Project is drafted on the basis of the Standard Form Project Deed (**Project Deed**). Project Co has an obligation to procure and maintain the 'Operational Phase Insurances' on the minimum terms specified in the Project Deed. In particular, Project Co is required to obtain an industrial special risk/consequential loss (**ISR**) policy with a total sum insured of in excess of $x.

After consultation with its insurance brokers, it has become apparent to Project Co that it will not be able to obtain insurance in the forthcoming year for certain risks to satisfy its obligations under the Project Deed.

In particular, Project Co anticipates that it will only be able to obtain 50% of the coverage required under the ISR policy. The existing insurers have also sought a broad-based exclusion for any claims in relation to notifiable diseases, which is required to be insured under the Project Deed.

To avoid the risk of being in breach of its obligations to insure, Project Co notifies the State that it considers that those risks are 'Uninsurable' under the Project Deed.

The party obliged to obtain the insurance may encounter difficulties in seeking to establish the 'Uninsurability' test under the Standard Form Project Deed.

For example, insurance for certain risks may not be readily available in the domestic insurance market due to capacity constraints. Capacity may be available in other insurance markets but not on commercially reasonable terms. That does not equate to unavailability, as that term would be ordinarily understood.

Paragraph (b) of the definition of 'Uninsurable' in the Standard Form Project Deed attempts to deal with the above issue. However, it may take considerable time to gather the supporting evidence to establish 'that the risk is no longer generally insured against in Australia or the United Kingdom by private sector providers of infrastructure similar to the Project Assets or activities similar to the Project Activities' (if satisfactory evidence is available at all). These issues will become apparent towards the renewal date when brokers approach insurance markets.

Where the emerging gaps in insurance coverage are significant, establishing 'Uninsurability' becomes a complex task and the parties would be at greater risk of dispute. If the insurance will need to be placed upon expiry of the existing program, a consequence may be that the parties must deal with any dispute on a retrospective basis after the insurance has been placed (which may not be desirable).

Case Study – State PPP Project – Part B[9]

Project Co and the State have received advice that substantial additional coverage is available in foreign insurance markets but the premium to obtain that additional coverage is double the cost of the premium for the existing coverage that Project Co's insurance brokers have been able to secure.

It is unlikely that Project Co would be able to satisfy paragraph (a) of the definition of 'Uninsurability' given that the additional coverage is available (despite the cost of the premium).

Project Co is considering relying upon paragraph (b) but will need to commission an expert report for that purpose which would take a matter of weeks to prepare. If the parties do not agree, then the Project Deed requires that the dispute be referred to expert determination. It is unlikely that the dispute would be resolved before the time the insurance is required to be placed.

8 This case study is for illustrative purposes only and does not represent a factual circumstance.
9 This case study is also for illustrative purposes only and does not represent a factual circumstance.

Rather than engaging in a dispute resolution process to determine whether an uninsured risk is 'Uninsurable', there are various benefits of seeking to negotiate an agreement to deal with those uninsured risks. This includes:

- greater certainty in the event an uninsured risk eventuates;
- may produce outcomes that would be mutually more favourable than relying upon the terms of the existing contract; and
- provide an opportunity for parties to scrutinise whether their insurance program remains fit for purpose (or whether the project may be over-insured).

In order to reach an agreement on the management of uninsured risks, parties should be prepared to depart from their existing risk allocation under the contract. The following matters would be relevant to those discussions (acknowledging that this would be more difficult to apply in the case of Systemic Risks):

- whether it is possible to predict the likelihood of the uninsured risk eventuating, noting that, although previous history cannot be used to reliably predict the probability of a risk occurring, certain factors may increase the likelihood of a particular risk, for example, the risk of damage to a physical asset would be increased where works are being performed in the vicinity of that asset;
- whether it is possible to quantify the uninsured risk;
- whether the uninsured risk could be shared or reallocated to a party (for instance, through adjusting the payments under the contract) and the extent to which that party has capacity to absorb the financial consequences of the occurrence of that risk; and
- whether the uninsured risk (or the consequences of that risk) could be mitigated by adopting other measures, for example, in relation to COVID-19 risk, by adopting appropriate health and safety measures to seek to prevent transmission of the virus.

In most cases, the cost of insurance is passed through the service payments in long-term contracts. There is usually not a perfect pass through. The pass through of insurance costs in the service payments could be perceived as a shift in risk back to the party which bears the economic cost of that risk through the insurance premiums to the extent it reimburses those premiums through the service payments.

Case Study – State PPP Project – Part C[10]

The circumstances are such that it is doubtful that Project Co would be successful in establishing 'Uninsurability'. A consequence is that Project Co would need to bear the risk of the uninsured risk if it were to occur.

The State is interested in keeping Project Co solvent and has capacity to indemnify the uninsured risk, provided that any State contribution be gradually set off against future service payments to Project Co.

Notwithstanding that it is not established that the risk is 'Uninsurable', there may be scope for the parties to avoid the expert determination process and reach a negotiated agreement to manage the risk.

If an event occurs which results in payment being withheld (for example, because the service is not provided) and there being no insurance in respect of that event, the parties will need to rely upon other avenues for recourse in relation to that loss, including any:

- contractual indemnities and rights to compensation; and
- cause(s) of action against a third-party for loss incurred.

These pathways will almost certainly be disputatious, involve additional time and cost consequences (potentially over a prolonged period of time for complex disputes) and may lead to an outcome which may not necessarily meet the parties' objectives nor be in the best interests of the project.

In the case of an action against a third-party, particularly those closely involved in the project, it is relevant to consider whether their balance sheet would be able to absorb the loss in whole or in part, the insurance available to them, the deterioration to the working relationship that could be caused by a protracted dispute and whether a protracted dispute would negatively affect the project.

10 This case study is also for illustrative purposes only and does not represent a factual circumstance.

08

Recommendations

The COVID-19 pandemic provides an unwelcome reminder about the extent of the utility of insurance. However there are undoubtedly other Systemic Risks with the potential to cause a disturbance of the same scale.

Whilst insurance is an essential risk transfer tool, the reality is that not all risks are covered by insurance and parties to long-term contracts should be prepared to deal with a change to the status quo in the absence of insurance.

The overarching question which then arises is whether the insurance obligations specified in a contract are fit for purpose and how this should be dealt with by the parties on a forward basis.

In considering both existing contracts and the drafting appropriate for new contractual arrangements, we suggest that the following matters be considered to the extent they are not already addressed:

- specifying only the necessary minimum terms on which the insurances should be placed;
- incorporating a mechanism to enable periodic review of the insurance program to identify whether the insurance program remains adequate and appropriate;
- incorporating a practical negotiation mechanism and binding dispute resolution process to deal with uninsured risks;
- seek to recognise that the placement of insurance is often a time critical exercise where particular premiums and coverages may only be available for a short period of time and provide a measure of discretion to the party responsible for arranging insurance, subject to that party being able to subsequently reasonably justify its decision so that to the extent the requisite insurance coverage was not obtained, any uninsured risks would be regarded as uninsurable; and
- considering whether a party would be able to indemnify the occurrence of certain uninsured risks in the first instance (which could be coupled with a partial set-off against future payment to the counterparty).

One benefit of self-insurance by a party is that the insurance premium which might otherwise be paid is saved at the price of the party bearing the particular risk. There is some evidence that State governments are pursuing this approach. The mission of agencies such as the Victorian Managed Insurance Authority is directed to this end. The efficiency of the suggested approach may be better demonstrated where the insurance sector is earning superior returns and the insurance market has hardened. Indicators are that the current hardening of the insurance market is likely to be protracted.

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