

When DSU Doesn't Work

“COD Wars”

Onshore Energy Conference

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What is DSU Insurance?

DSU indemnifies for the loss of anticipated future earnings of a future business.

DSU aims to put the insured back to the position that they would have been in, had the incident not occurred.

Extract of Typical wording for DSU cover:

- Subject to provisions, terms, exceptions, conditions and memoranda contained herein, the insurers will **indemnify the Principal in respect of the actual loss sustained** from deferred receipt or partial receipt of revenues as a result of the delay in completion of the permanent works beyond the scheduled commencement date of the business.

Rules for Managing DSU

2 key components:

- Actual Commercial Operation Date (ACOD)
 - *What the insured actually achieved*
- Scheduled Commercial Operation Date (SCOD)
 - *What the insured would have achieved absent the incident*

$$\text{DSU} = \text{ACOD} - \text{SCOD}$$

➤ **Understanding and calculating SCOD is key to determining DSU**

What is SCOD?

SCOD Definitions

Literature Definitions

- *“The date specified in the schedule upon which the business insured would have commenced had the delay in start-up not occurred”*. (Alderton, Norman et al., ‘Insurance of Revenue for Projects Under Construction’ (London, 2003), P.79)
- *“The date on which the business could have commenced had no insured event occurred which ultimately results in a delay of the actual business commencement date, but not earlier than the date stated in the schedule”*. (Bommeli, Max, ‘Delay in start-up insurance’ (Swiss Re, 2003) P.14)

Policy Definition Examples

- *“The provisional dates stated in the schedule to this section or such other later dates as may be agreed between the Insured and the Insurers being the date of Commencement of Initial Operation of the Business or the date on which the Business would have commenced had the Delay or Interruption not occurred”*.
- *The later of the completion date scheduled in the construction contract and shown on Page 1 of this endorsement, or the date the INSURED PROJECT would have been completed for commencement of commercial operations or use and occupancy if a loss hadn’t occurred”*.

What is SCOD?

SCOD : The date upon which the Insured Business / Commercial Operations would have commenced had the Delay not occurred

- What does Insured Business / Commercial Operations mean?
- Very rarely a defined term in the policy
- For Power and Energy claims this can become a difficult issue. Is Commercial Operation:-
 - *The date of first on spec product / generation?*
 - *The date at which production would be profitable?*
 - *The date at which production first reaches 100%?*
 - *The date of handover from Contractor to Owner?*

What is SCOD?

- In our experience - Commercial Operation is taken from when the business sustainably reaches 100% operation
 - *The Indemnity Period starts on SCOD*
 - *However, indemnification would only commence when 100% operation is reached*
 - *Consequently, the insured are not indemnified for losses before reaching 100%*

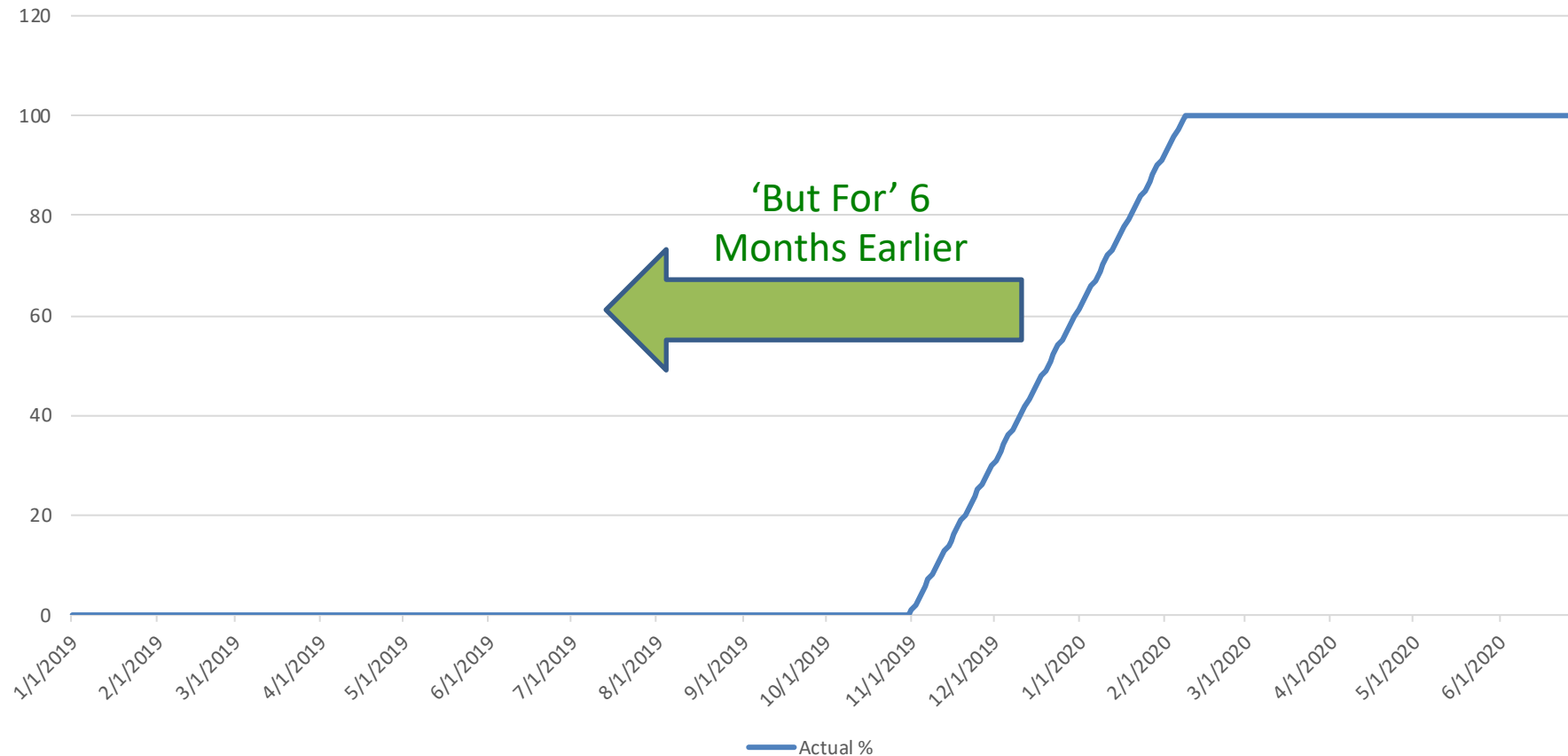
Does DSU put the insured back to the position that they would have been in, had the incident not occurred?

Example Case 1

- A Coal Fired Power Plant (CFPP)
 - Two key completion Milestones:
 1. Commercial Operation (CO)
 - 100% operation, completion of commissioning.
 - Commencement of 90 day Performance / Reliability Tests
 2. Final Completion (FC)
 - Completion of Perf. Rel. Tests
 - Handover from Contractor to Owner.
- DSU specifically linked to FC – *as identified in the schedule & contract documents - **Unusual***
 - *No resulting discussion needed to define what Commercial Operation is meant as.*
 - *But, what does using FC mean for DSU calculations?*

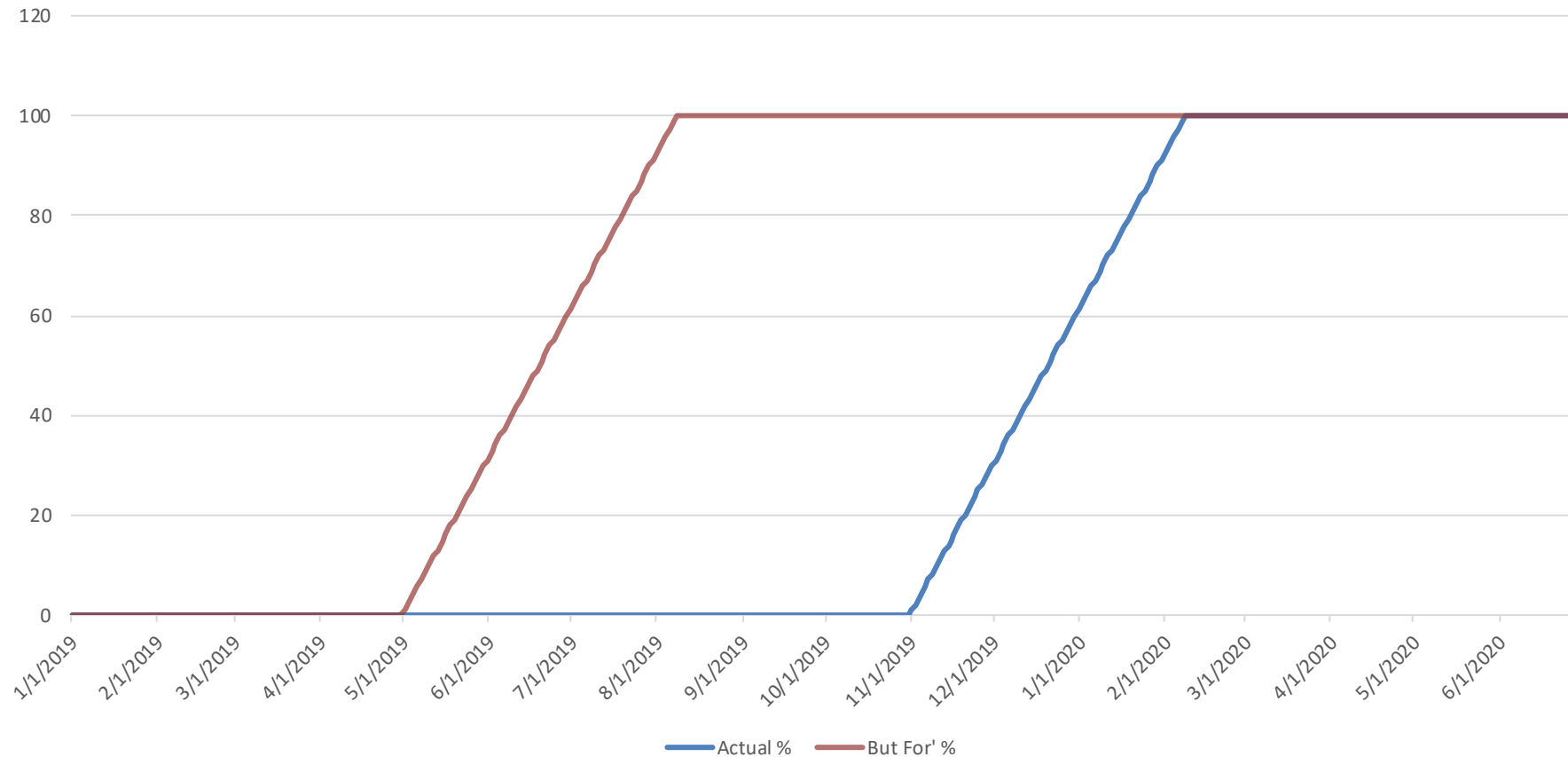
What is COD?

CFPP Ramp-Up Scenario



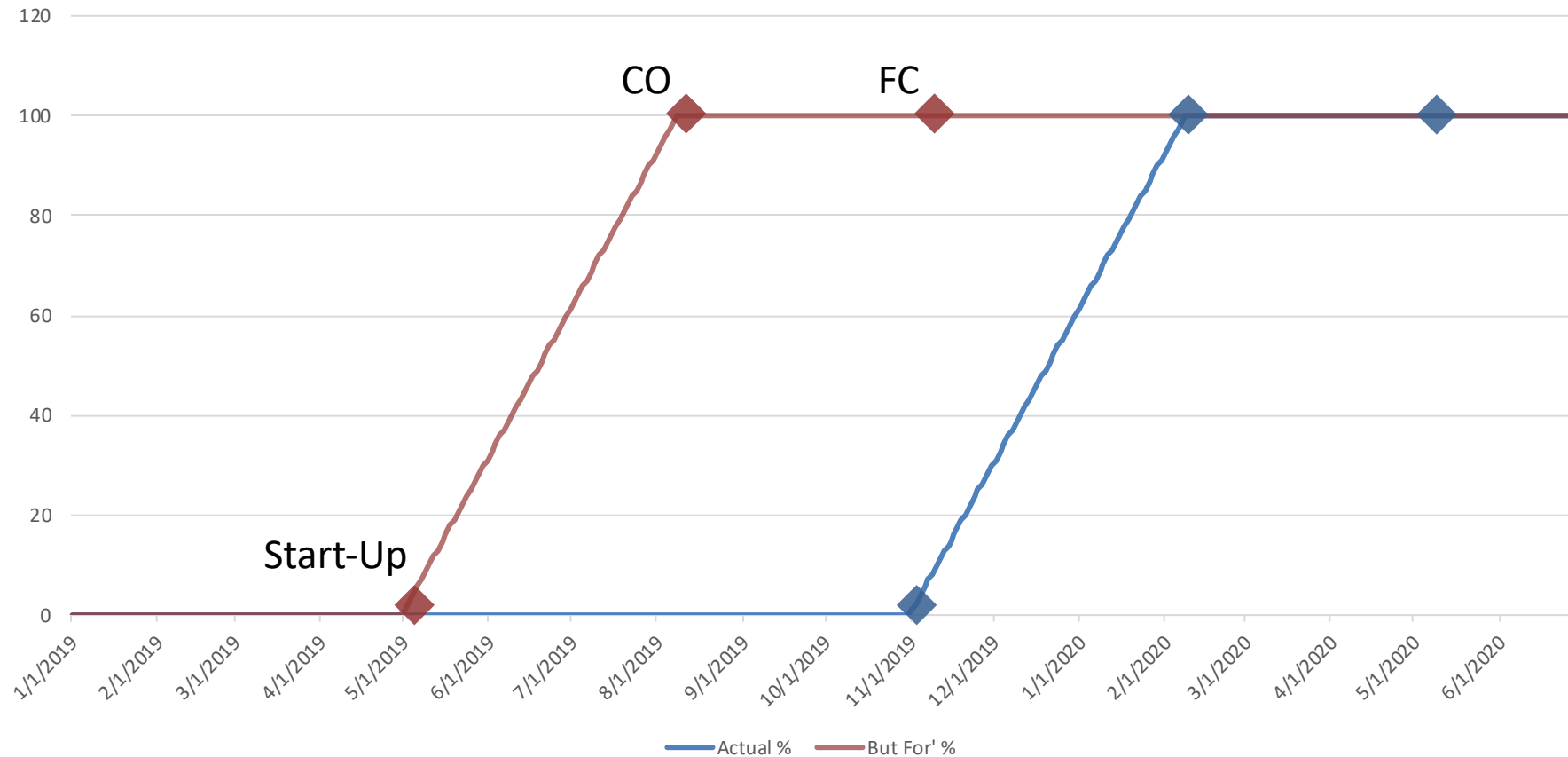
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CFPP Ramp-Up Scenario



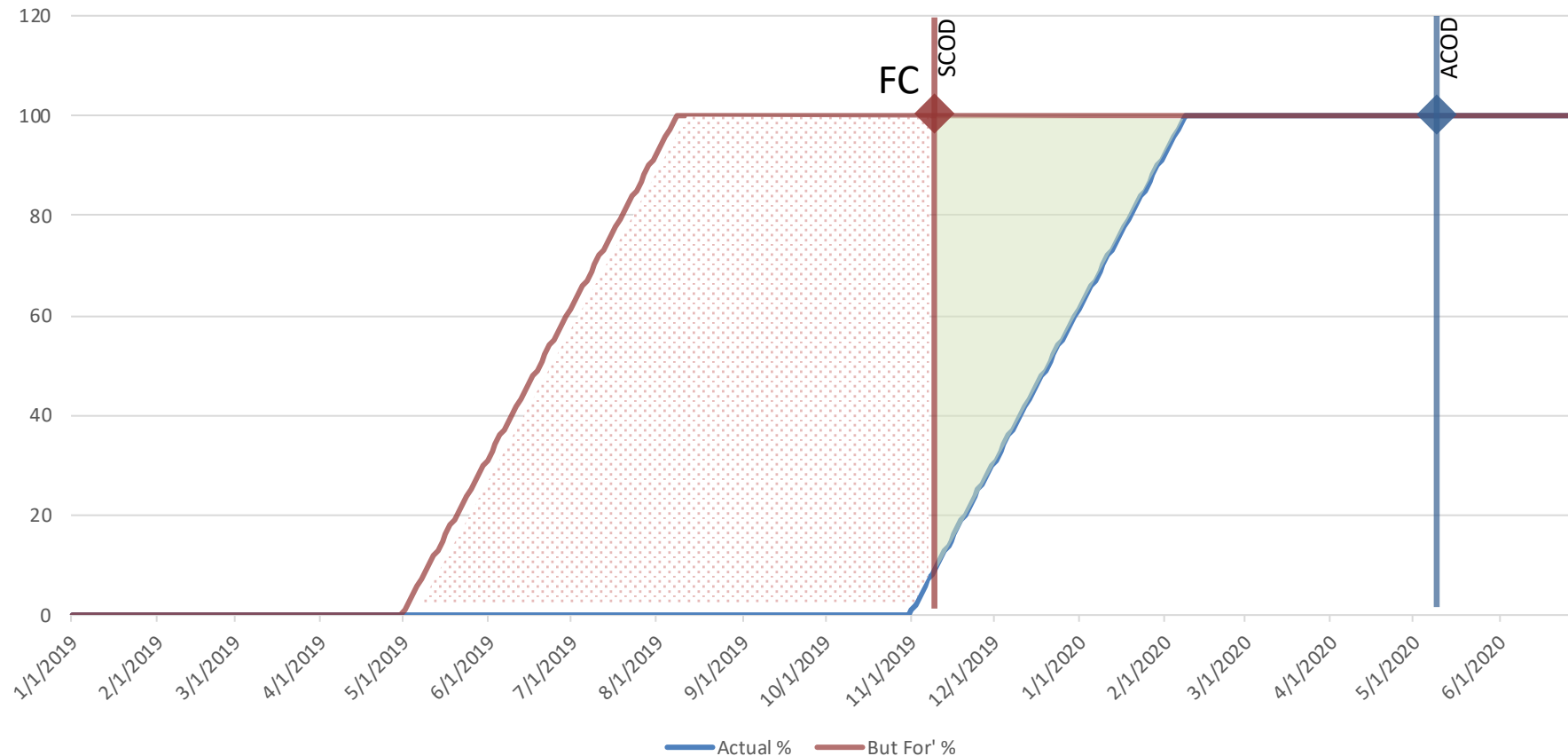
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CFPP Ramp-Up Scenario



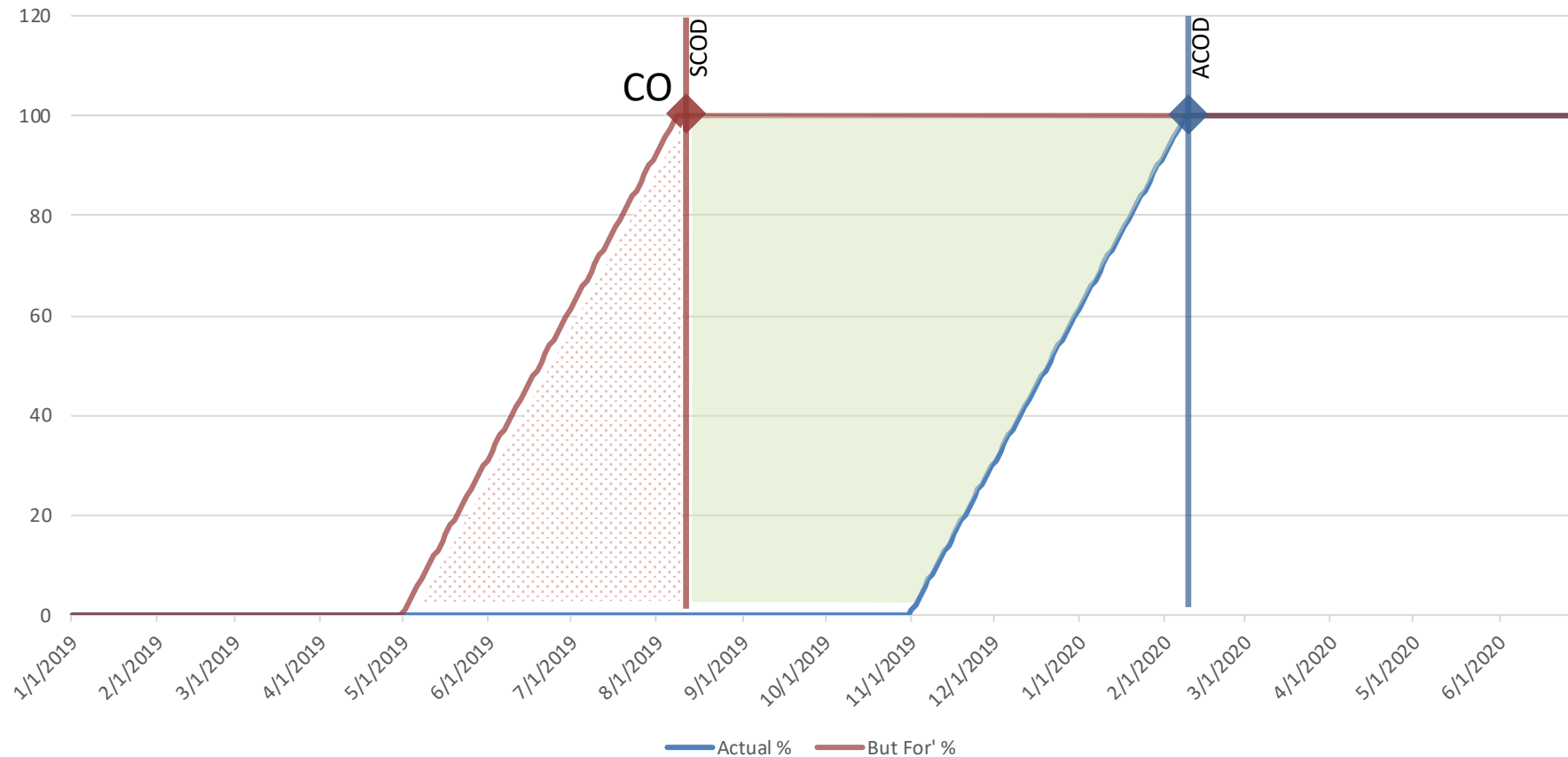
What is COD?

CFPP Ramp-Up Scenario – What actually happened



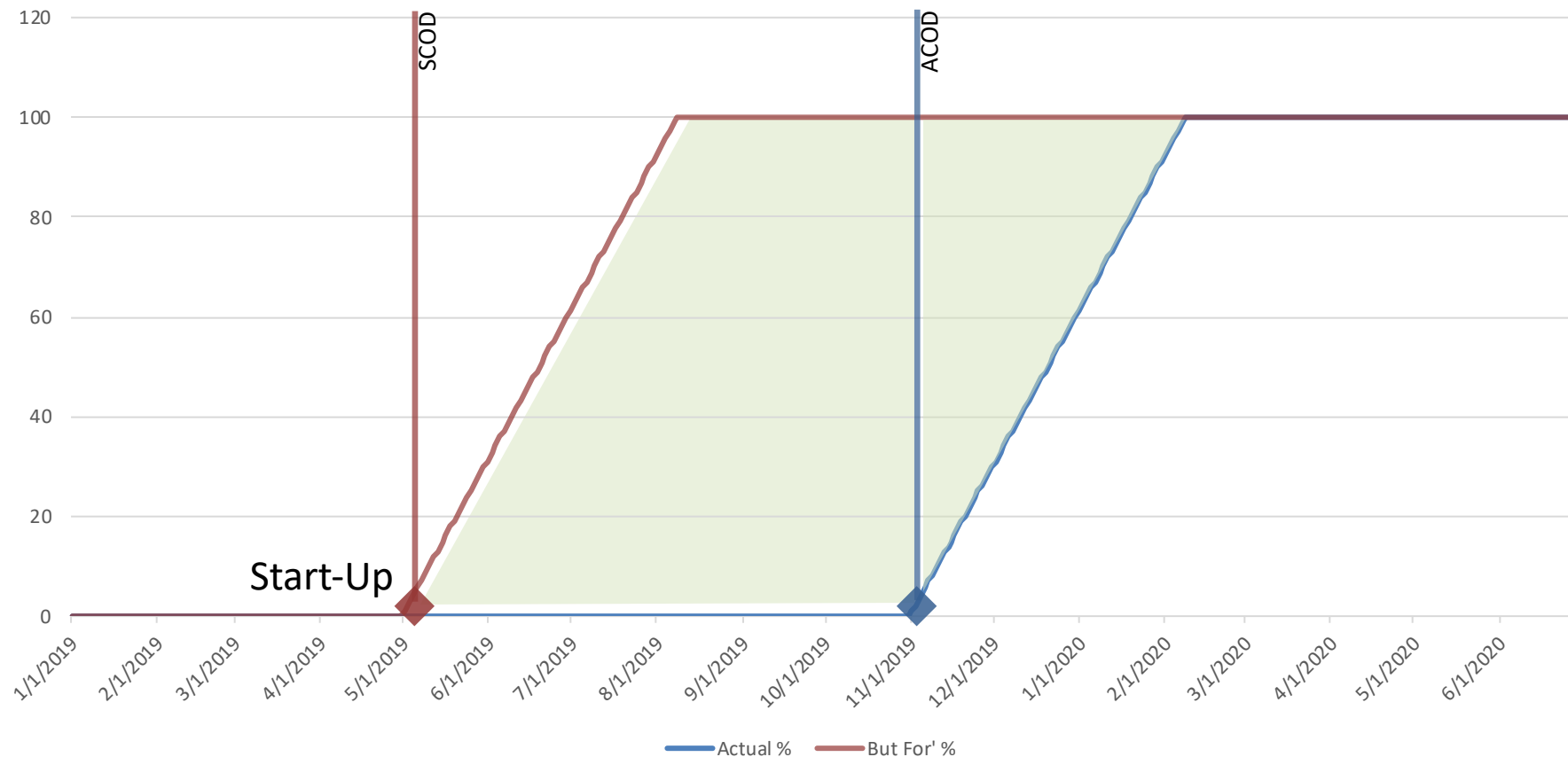
What is COD?

CFPP Ramp-Up Scenario – at 100%?



What is COD?

CFPP Ramp-Up Scenario – At start of Ramp Up?



Example Case 1 - Summary

- Assuming 6 month delay was accepted by all parties
- DSU was clearly linked to Final Completion – No area for dispute.
 - *However, would the insured have accepted the DSU calculation?*
- *Whilst 6 months was accepted, linking to Final Completion meant that very little of the ‘Actual Loss Sustained’ was actually covered*
- *Ultimately, this claim took more than 2 years to resolve*
- ***Is this what the Insured believed they were buying?***
- ***Is this what underwriters really intended?***

Majority of “loss” not indemnified

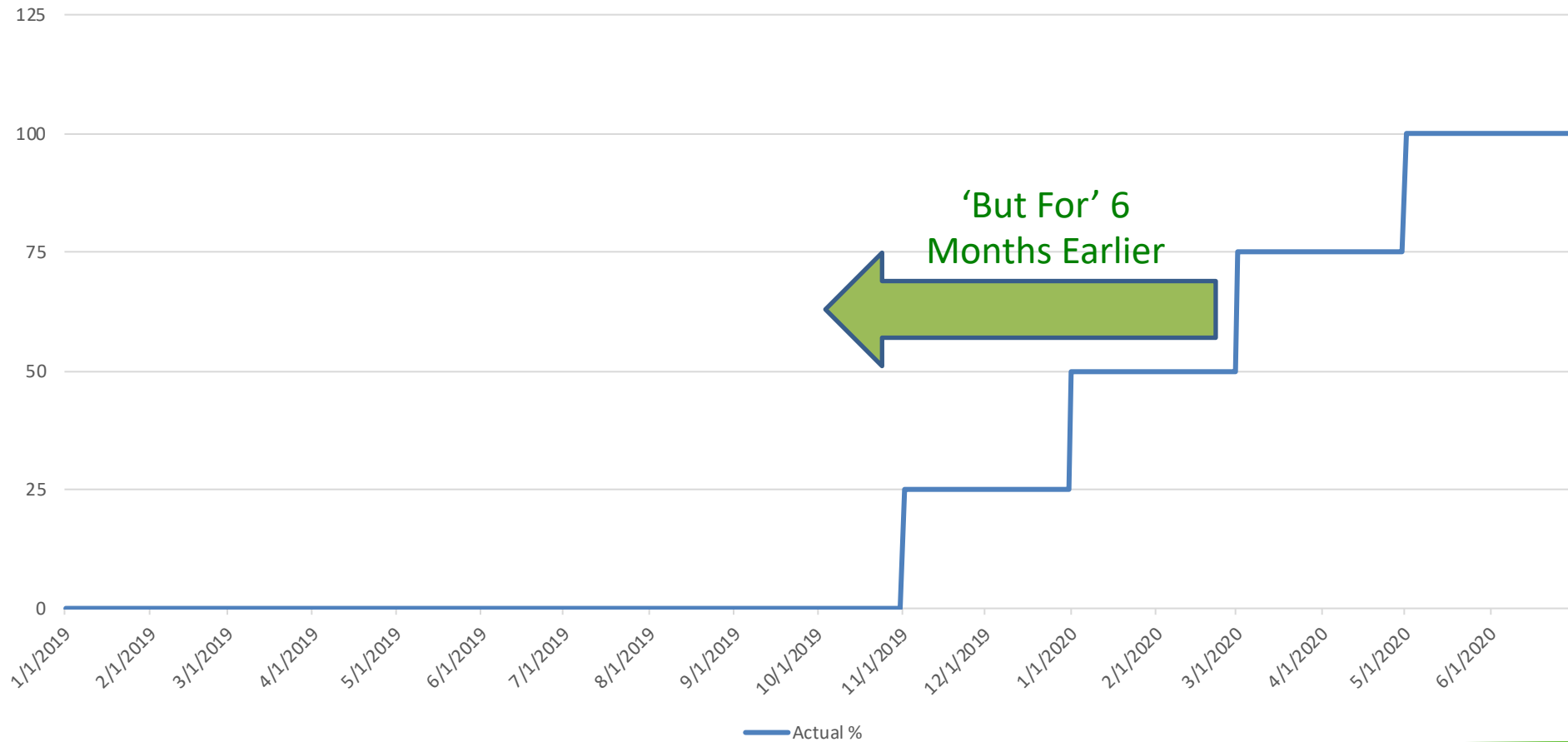


Example Case 2

- A Container Terminal with multiple handover dates
 - Five key completion Milestones:
 - 25%, 50%, 75% and 100% - incremental handover
 - Each milestone represented a portion of the capacity of the terminal to be handed over
 - Final Handover (FC)
 - Handover from Contractor to Owner – this is when the Reliability Period started
- DSU specifically linked to “Commercial Operation”
 - *No policy definition to explain what “Commercial Operation” was*
 - *The Insured argued it meant 100% operation – i.e. Handover Milestone*
 - *Could it have been argued that it meant:-*
 - *Start of Operation?*
 - *The capacity needed to break even?*

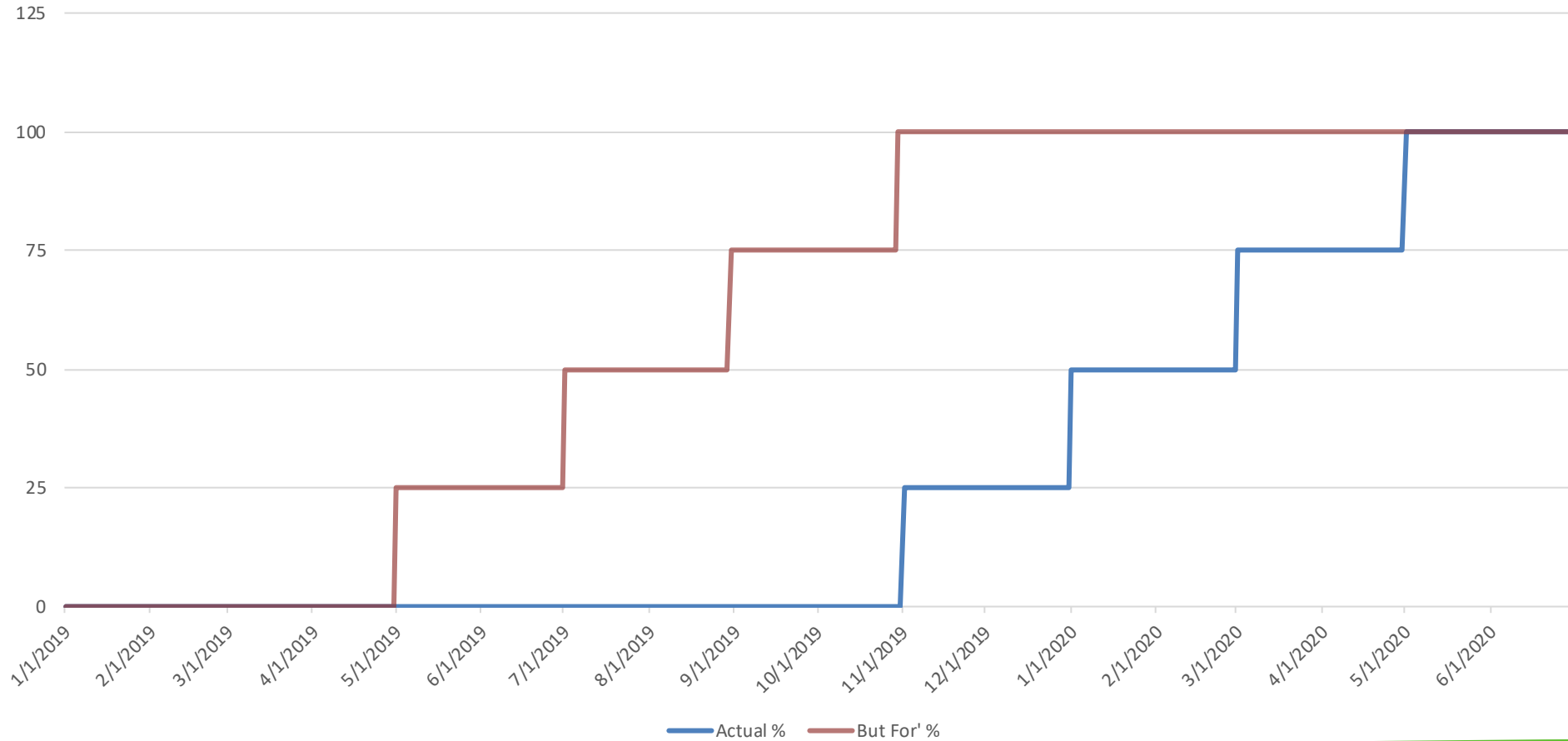
What is COD?

Phased Handover Scenario



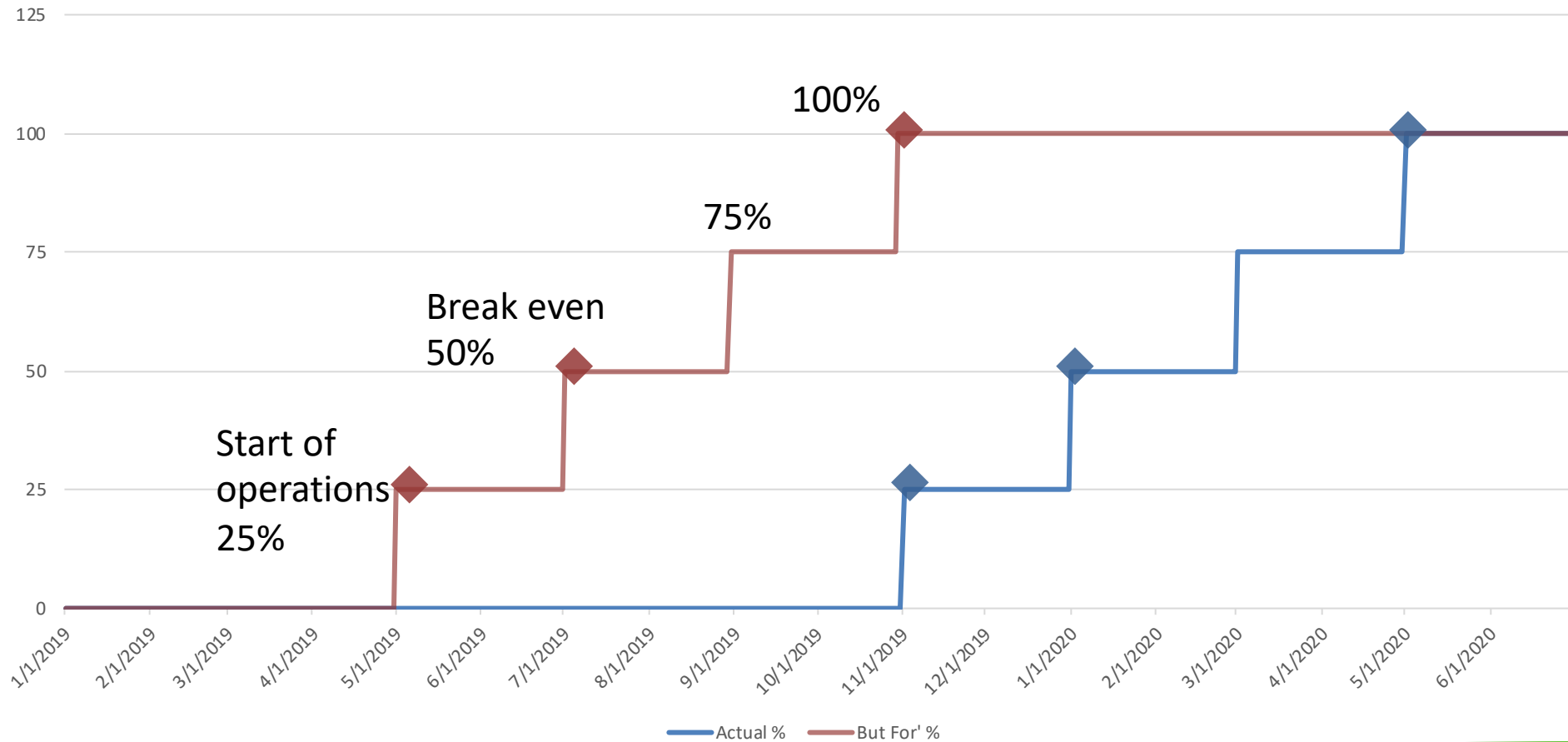
What is COD?

Phased Handover Scenario



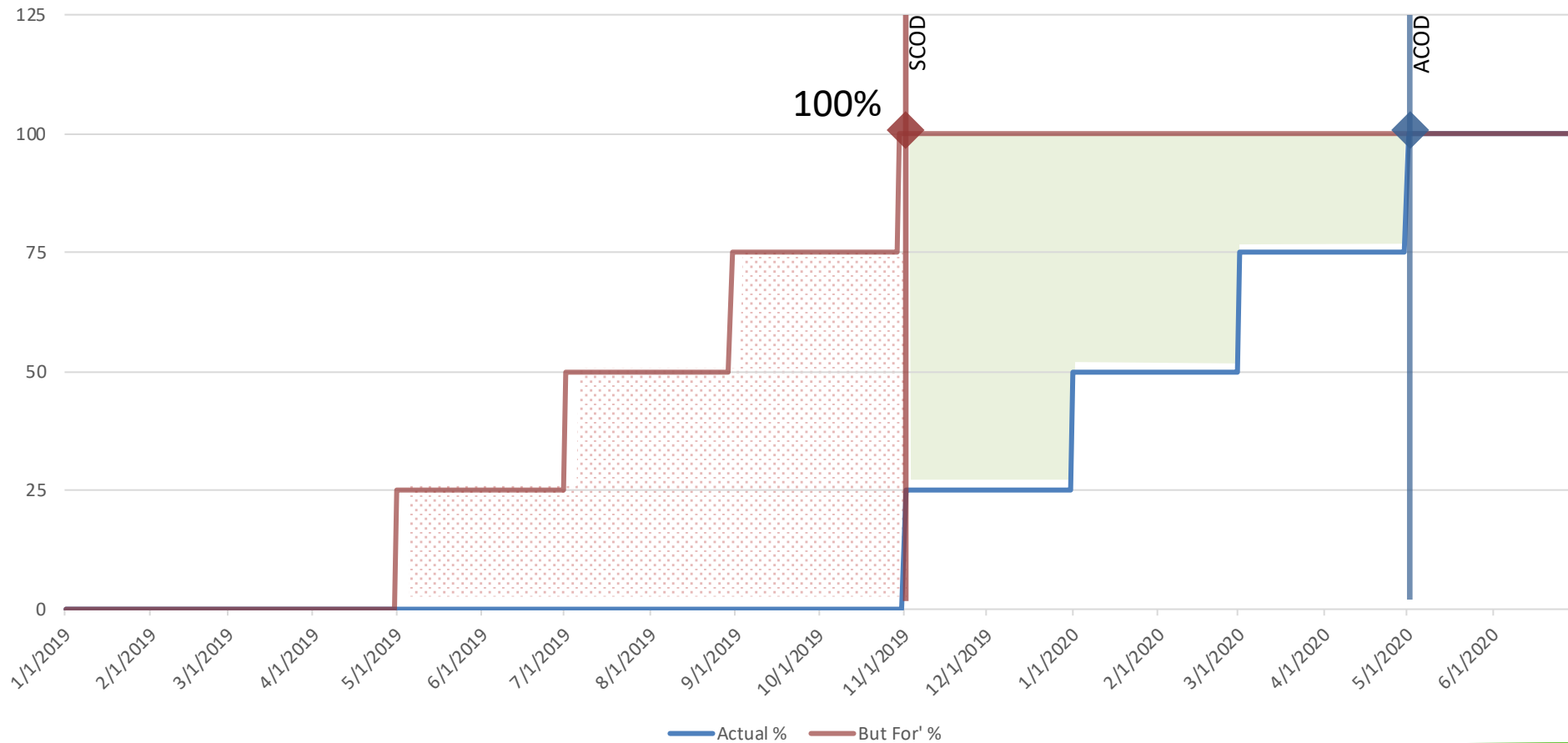
What is COD?

Phased Handover Scenario



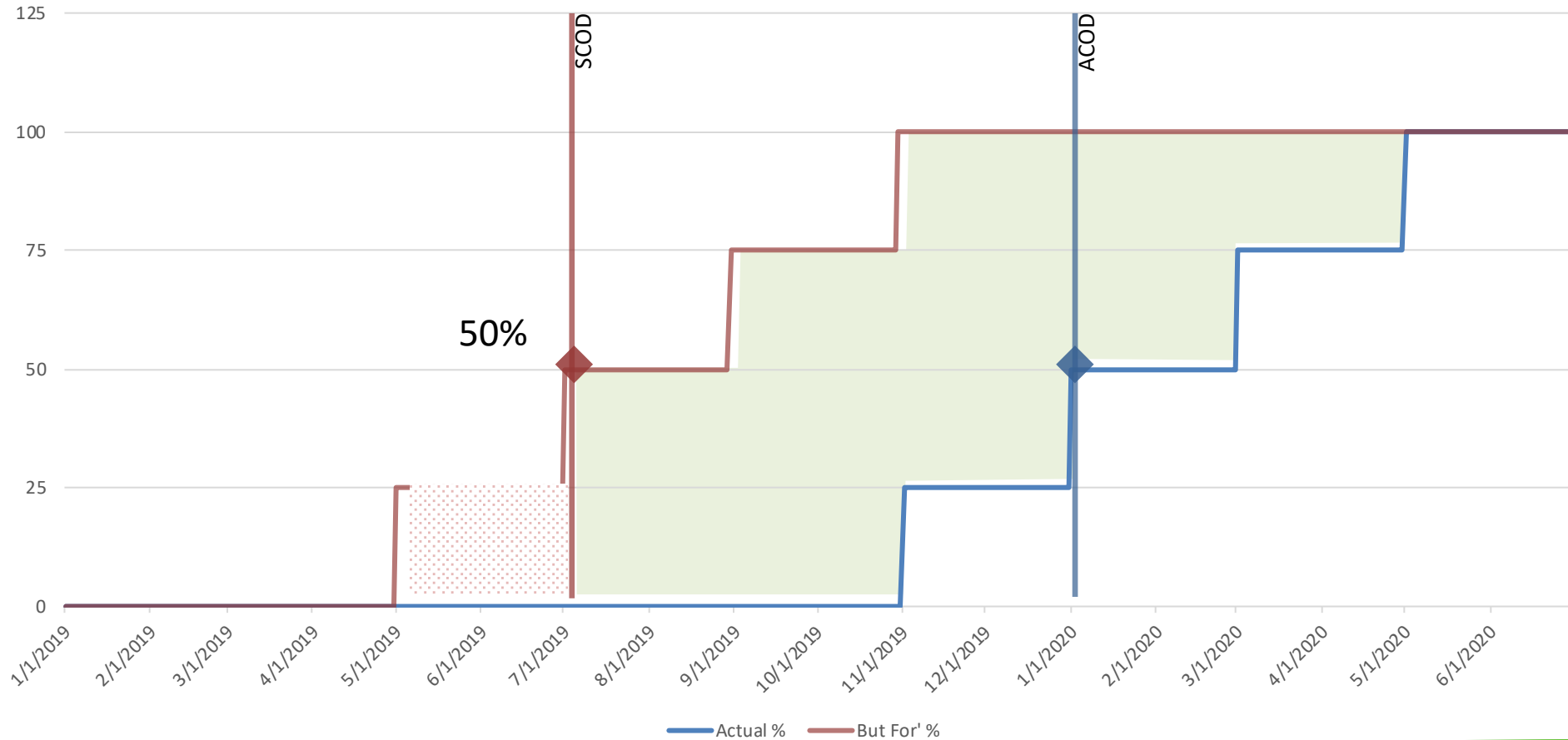
What is COD?

Phased Handover Scenario – What actually happened...



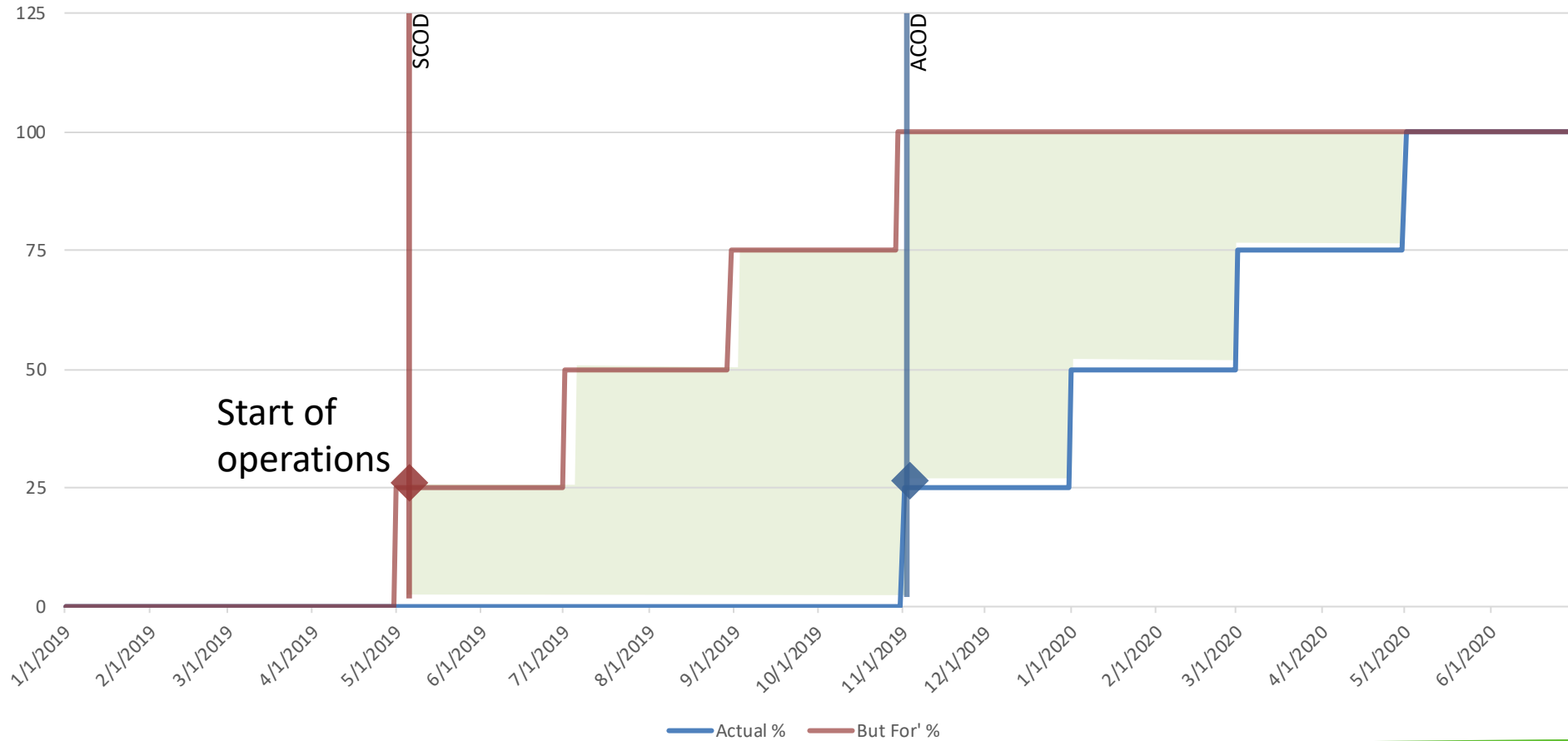
What is COD?

Phased Handover Scenario – At ‘break even 50%’?



What is COD?

Phased Handover Scenario – At first H/O?



Example Case 2 - Summary

- Measuring DSU against Commercial Operation creates ambiguity – in relation to how much of the Actual Loss Sustained is covered
- Using 100% operation as CO does not indemnify fully
- ***Is this what the Insured believed they were buying?***
- ***Is this what underwriters really intended?***

Summary

- From a conceptual point of view – if policy conditions are satisfied, Insured would expect to be put back into a financial position as if the loss had not occurred
- Simply measuring from “Commercial Operation” does not always work
- For Energy and Power losses, it rarely works - or, any project with a ramp up or phased handover
- Measuring DSU from the start of production / first on-spec product
 - Seems to fit with principle of DSU
 - Allows full indemnification (Indemnity Period notwithstanding)
- ***What do underwriters actually want to cover?***
- ***Is it seen as ‘shared risk’ – do Insureds understand this?***
- ***It does not necessarily provide cover for ‘Actual Loss Sustained’ – so what is being priced when the Actual Loss is not being covered?***
- ***Uncertainty leads to disputes***

Timeline
Forensics

Reinstatement
Support
Management

Project
Monitoring

Cost Analysis
& Management

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Questions