Marine Delay in Start-Up (DSU) Insurance

Why do more project owners and their lenders demand Delay in Start-Up cover?

Introduction

Marine Delay in Start-Up (DSU) insurance has been one of the few growth Areas in marine insurance in the recent past, due to increased demand for protection, as financiers and project owners realize the potential financial impact on a project due to a delay in critical component delivery to the construction site.

The increasing complexity of projects, and the development of large pre-assembled modules (PAMS) offshore for many critical components, have only fuelled the demand. Transporting PAMS to site requires the construction of new infrastructure, shipping, and handling facilities, since they test or exceed the known limits of existing facilities. All of these factors add to the complexity of underwriting project risks.

Marine DSU triggers and insured perils

The prerequisites to trigger a claim under a Marine DSU policy fall into three categories:
1. Loss due to **material damage**
2. Occurrence of a **fortuitous event** to the conveyance
3. Loss due to uncontrollable **maritime events**

1. Loss due to material damage

Standard Marine DSU perils follow the cargo placement clauses of the wide accidental damage cover under ICC(A) plus War and Strikes.

Cover for on-deck shipments or critical project items not subjected to pre-shipment survey usually is restricted to ICC (C) coverage, as long as there is material damage loss under the policy's cargo section.

Problems arise for cost insurance and freight (CIF) purchases, since the lack of insurable interest under the cargo section will not trigger a DSU claim. Any attempts to circumvent this through additional clauses are likely to fall foul of the insurable interest provisions of the Marine Insurance Act 1909.

Underwriters and Insured need to exercise care if there is a significant inland transit prior to departure, or where the CIF cover is to the port of discharge. In both cases, there will be significant uninsured DSU exposures to address.

2. Occurrence of a fortuitous event to the conveyance

Wordings also respond where the delay is attributable to loss, damage or mechanical breakdown of the conveying vessel or aircraft that would be indemnified under a standard form of Hull Clauses cover or Aviation Insurance policy.

The wordings go further when it comes to other forms of conveyance to include delays attributable to loss or mechanical breakdown of these 'other' conveyance forms. While these wordings do not qualify the type of conveyances, they presumably refer to land-based road/rail conveyances.

There is also no definition of what may constitute mechanical breakdown, other than to limit the event to one of fortuity. Thus, expect a very broad Common Law interpretation to be applied to these words.

3. Loss due to uncontrollable maritime events

The final triggers relate to the vessel becoming engaged in a General Average event or Salvage or Lifesaving Operation.

The recent spate of piracy events which can escalate to General Average claims has created exposures that probably were not considered when the wordings were drafted, but that are now real.

Similarly, the increase in asylum-seekers aboard leaky vessels in Asian waters has resulted in Lifesaving Operations taking on a new, increased exposure if those being rescued refuse to disembark unless certain conditions are met.

Risk management and loss control of these exposures is critical and requires a lead underwriter with the structure and global reach to adequately manage them.

Soft market conditions can lead to extensions, introducing clauses that surpass Marine DSU risks with no requirement for an insured material damage loss. In most cases, expert, reliable data is lacking on which to base a sound underwriting decision. Broadening basic cover should be done with great care to ensure the exposure can adequately be quantified and the capability exists to apply loss control and risk management techniques.

Underwriting and risk assessment

Marine DSU underwriting involves arriving at a base rating that has strong parallels to the cargo underwriting of the specific risk. A series of additions and subtractions can be applied to this base rating according to the underwriter's comfort level with the reliability of provided information, including such factors as local repair facilities, availability of spare parts, and so on.

Unfortunately, in contrast to construction insurance submissions, rarely is quality data provided with a Cargo/DSU quotation slip related to the loss control techniques likely to be employed in order to manage the risk factors inherent in safely transporting critical items to site.

The next step in the underwriting and risk assessment of a Marine DSU account is to review timelines for the projected arrival of the critical components at the site, estimated reorder periods and what impact, if any, these factors will have on delaying the project start-up date.

Testing and commissioning periods during which little or no revenue is produced can be an important factor.

Applying daily indemnity amounts to the possible number of days of project delay for each of the critical items will enable realistic assessment of the exposure.

Comparing this calculation to the sums insured or limits requested should provide logic that can be applied, positively or negatively depending on the outcome, to rating factors.

The final step in the underwriting process of underwriting Marine DSU is to determine what risk management or contingency plans are in place to mitigate any loss, including simple factors like identifying replacement units, enacting agreements to expedite the production of replacement units in advance, employing workarounds while awaiting replacement units and, if necessary, applying more complex contingency plans.

In preliminary planning before placement, clients and brokers are wise to work through 'what if' alternative solutions in the absence of insurance protection of the impact on revenue of loss of critical items in transit.

Supplying contingency planning information for any transit losses related to critical items with a Marine DSU slip, for example, would significantly influence the underwriter's acceptance and pricing of the risk.

Marine DSU sum insured

Calculating an appropriate DSU sum insured can be simplified in the construction risk by making a 'worst case scenario' assumption of a total loss on the last day before hand-over of the project.

The process is far more complex, however, when it comes to the marine transit risk, which usually involves multiple shipments of a range of critical components stretching over a number of years. Each component will have a different impact on the scheduled completion date of the project, depending on the planned arrival date at the site and lead times for reordering damaged or destroyed items.

There are no magical solutions to this problem other than to run through a series of hypothetical 'what if' scenarios and then to customize the type of indemnity and amounts around these.

Factors to consider include:

- Non-recurring expenses or development costs
- Take-or-pay agreements
- Depreciation
- Cost overruns
- Split production trains
- Multiple losses/loss of replacement units
- Overlap between insured and non-insured perils and construction insurance policies

Marine DSU interests

The original Marine DSU wordings were very basic and designed to indemnify an insured for a proportion of standing charges to continue, irrespective of any reduction in the revenue stream. It would be calculated as a simple rateable percentage that standing charges bear to anticipated revenue that would be applied to any reduction in turnover. Often it was quoted as a daily monetary amount. Over time, cover was expanded to include an element of net profit under a very rudimentary 'additions method'- style loss of profits insurance. The range of interests has evolved further as project owners, financiers, and brokers have gained appreciation for the precise needs of a specific project.

The range of DSU Interests can now include items such as

- Gross revenue cover
- Gross profit cover
- Standing charges
- Increased cost of working
- Additional increased cost of working
- Claims preparation expenses
- Liquidated damages
- Take or pay contractual commitments
- Salaries and wages
- Loss of bonus
- Expediting expenses
- Interest payments/refinancing costs

What is appropriate for a specific project can only be determined after a thorough analysis of the projected financials or pro-forma financial statements for the specific project related to arrival of critical components at the site. Making assumptions based on past projects is dangerous; construction methods are constantly changing.