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BG ITALIA,

“BRINDISI LNG IMPORT TERMINAL PROJECT

INSURANCE MEASURES FOR RISKS TO PERSONS, PROPERTY AND ENVIRONMENT”

Brindisi LNG Import Terminal Project
Insurance Measures For Risks to Persons, Property and the Environment

Introduction

Summary

This paper sets out the basic proposed philosophy behind the insurable risk allocation for the project and prospective insurance strategy. It examines the various influences that will drive the Project insurance whilst also outlining the scope of cover to be arranged.

Present Worldwide Insurance Market Situation

The onshore construction insurance market has changed significantly over the last twelve months or so, in an attempt to stem a series of substantial losses (mainly refinery risks) over many years. The direct insurance market under pressure from their re-insurers have attempted to correct the situation by;

- Increasing significantly the levels of self-insured retentions,
- Withdrawal or restriction of coverage including limitation of 'ancillary' covers such as suppliers and customers extensions, and most importantly the terrorist risk,
- Substantial increases in premium,

These measures together with a partial reduction in capacity caused directly by the withdrawal of certain markets unwilling to underwrite the risk at all, has led to a difficult market skewed significantly towards the seller, and dominated by a handful of major players.

The World Trade Centre incident on September 11th will result in the largest insurance claim of all time, possibly as much as US$50 billion, and will materially change the structure of the insurance market as a whole. The repercussions of the incident have obviously exacerbated the downward market trend, and will lead to insurance market failures, reductions in capacity due to lack of reinsurance, and question marks against the financial solvency of even the strongest insurance markets. The most immediate critical period of time has now arrived where the insurance market has renewed its existing re-insurance contracts and the results do not appear to be positive for insurance buyers.

Proposed EPC Risk and Responsibilities

a) Employees

Within the indemnity provisions of the EPC contract, an individual contracting entity is responsible for its own liabilities arising as a result of death, sickness or injury to its employees regardless of the negligent acts of others. The primary reason for this risk allocation is to avoid the excessive costs which can arise where there are disputes as to causation and hence degree of liability. The employing entity is also in the most appropriate position to judge its own employee risk, and hence to decide on the most suitable risk financing strategy.

This mutual hold harmless provision does contain an exception for acts of wilful misconduct as defined in the Contract. This is meant to avoid the application of a hold harmless where an act of wilful misconduct could jeopardise any insurance recovery.

b) The Project Works

Whereas BG will arrange project insurance the Contractor is made totally responsible for the care of the Works and the Plant, including whilst in transit, until Risk Transfer date as defined in the Contract, and whilst 'making good' during the Defects period.

c) Contractor/Company Own Property

Each individual contracting entity is responsible for loss of or damage to its own physical property (excluding the Plant and the Works), regardless of the negligent acts of others, arising out of or in connection with the Contract. Each individual contracting entity is in the best position not only to assess its own property risk exposure, but also to decide upon their own preferred risk transfer option. If loss arising from the negligent act was not excluded, then a dual insurance situation could occur, whereby a negligent party would need to purchase liability insurance protection for a risk, which is already insured under a first party insurance arrangement.

d) Third Party Liability

The objective of the EPC indemnity provision is to make the Contractor responsible for all liabilities in respect of injury, death, loss or damage to Third Parties and or their property arising out of or in connection with the Contract. As access by Third Parties to the Works is nominally controlled by the Contractor, it is not unreasonable for them to assume responsibility for this risk exposure. The Contractor would normally seek to dilute this by excluding the contributory negligence of the Company Group and to limit their indemnity to a reasonable sum e.g. US$3 million or as otherwise agreed. Above this limit the project policy would indemnify against any loss.

With regard to environmental issues the EPC contractor is responsible for damage resulting from the Works, unless contributed to through the action of BG.

e) Consequential Losses

There is a mutual hold harmless indemnity regime in force in the EPC draft contract between Company and Contractor in respect of 'Consequential Losses' as described, with the exception of performance related liquidated damages which are specifically provided for elsewhere in the Contract.

Proposed EPC Contract Insurance Requirements

A brief description of the main types of insurance coverage referred to here is provided in Appendix A.

a) Contractors Insurance Requirements

The Contractor and its Subcontractors to provide an insurance programme, which satisfies two minimum requirements. Firstly, the Contractor/Subcontractor must comply with Italian legal requirements. Secondly, they must provide a minimum level of risk finance protection in order to satisfy the Project that there is a capability to satisfy the liabilities being assumed under contract, according to the agreed risk allocation. The minimum requirements are set based upon a reasonable estimate of the potential losses arising. The insurances required are:

i) Employee Risks – Workman's Compensation benefits to comply with all relevant regulation and legislation and as applicable Employers Liability Insurance subject to minimum limits e.g. £5,000,000 any one occurrence or series of occurrences arising from one event.

ii) Contractor Property Risks – There is a requirement to insure Contractor's property for 'all risks' of loss or damage, which could include Plant or indeed marine vessels. The main reason for this requirement is to ensure that particularly in the situation where damage occurs to items that are critical to the Project, that adequate risk finance is available to ensure prompt replacement.

iii) Contractor Liability Risks – In addition to the compulsory Auto liability insurance requirement, it is normal to require the Contractor to provide a primary legal liability insurance, including pollution cover, up to a limit of indemnity of US$3 million any one occurrence. The Liability insurance arrangements purchased by the BG as part of the Construction Insurance package, would act as coverage for catastrophic incidents in excess of this amount.

If appropriate, there would be a further requirement on the Contractors and Subcontractors, to provide an acceptable level of P& I insurance. This would deal with the liabilities arising primarily due to the movement of marine vessels arising in connection with the Project. There is a similar requirement for Aviation liabilities arising from the use of aircraft including helicopters. Each of these types of insurance are specialist covers, which should be left to be purchased either by the vessel or aircraft owners individually.

b) BG Insurance Requirements

In order to manage and control the cost and extent of effective risk transfer for the Project Works, the Company will provide a Construction Insurance package to include all interested parties as additional insured's. This will comply with local laws, will be placed with insurance markets of acceptable financial standing, and will include all of the requirements of the various interested parties under contract, where possible at a reasonable cost. The package will comprise three main sections, all of which are more fully described in Appendix A:

i) Construction 'All Risks' including materials whilst in transit,
ii) Delay in Start Up of the Project,
iii) Third Party Liability.

Given the competing interests of Contractors, Subcontractors, Company and Financiers, and taking into account the size of the placement required and the difficult market conditions, the final cost and extent of the coverage is difficult to predict.

c) Operating Insurance

In previous years in less difficult insurance market conditions, it would have been part of an onshore construction Insurable Risk Strategy to include one year or more of insurance for the operating risk exposure within the Construction Risk Insurance package. By using the same insurance market, this avoids the typical type of causation (and responsibility) disputes that can arise in construction projects in respect of occurrences emerging soon after Project completion.

Although this will still form part of the theoretical Insurable Risk Strategy, market conditions might dictate that this follow on cover is not available. In such circumstances the coverage would be placed with suitable alternative underwriters.

Conclusions

i) The described insurable risk allocation within the EPC contract provides a cost effective and efficient spread of risk exposures between the contracting entities, which leads to a clear split of risk transfer responsibilities as detailed.

ii) As the major portion of the risk exposures generated by the Project will effectively be retained by markets around the world, it is proposed that the main focus of the Project Insurable Risk Strategy is directed with these markets in mind.

iii) In the current onshore construction insurance market (short and medium term view) post WTC, there is a greatly reduced, financially suitable, risk transfer capacity available for a Project of this size, particularly should a large DSU sum insured be required. There is certainly a great unwillingness on the part of the worldwide insurance/reinsurance market to under-write this class of business on terms at or near those provided in recent years.

iv) Placement of a Project Construction Insurance package of this size in the short to medium term will require significant worldwide capacity. Choice of markets with the ability to lead this risk to ensure a 100% placement is also very limited.

v) The ultimate aim is to ensure clarity for the responsibility of the Contracting parties for damage to property and or third party risks and to provide for adequate insurance protection in accordance with the Risk Transfer Philosophy

APPENDIX A – Main types of Onshore Construction Insurance Coverage

Construction 'All Risks' Insurance (CAR)

'All risks' of physical loss of or damage to the project works to be undertaken as a result of the Project arising during the construction period and including during the maintenance period.

Third Party Liability Insurance (TPL)

Legal liability to third parties for personal injury or property damage arising as a result of engineering, procurement and construction activities, occurring anywhere in the World in respect of works to be undertaken in connection with the Project.

Delay in Start-Up Insurance (DSU) (if appropriate)

Losses sustained as a result of the delay in start up of each train beyond the anticipated completion date, if caused by physical loss or damage caused to the project works (includes cargo in transit) and insured under the CAR and Cargo insurances.

Cargo Insurance (Cargo)

'All Risks' of loss or damage to materials, supplies, equipment and goods required for the Project whilst in transit from manufacturers or suppliers premises to the project site, including whilst in temporary storage.

Operating Insurances

The operating insurance package would provide cover for 'All Risks' of loss or damage to the completed LNG assets, including Machinery Breakdown. It would also provide coverage for financial losses arising as a result of that loss or damage including increased costs of working. A Third Party Liability coverage applying to the operating activities would be purchased.