The Role of Environmental Insurance in Project Finance and PFI Projects

Effective management of environmental risk is a hallmark of successful development projects. This is particularly critical in project finance and/or PFI deals which generally involve a large number of participants within a complicated contractual framework.

In view of the increasing complexity of these deals and the nature of funding arrangements, project lenders require exhaustive reassurance that all project risks are identified and adequately controlled or, ideally, transferred.

Environmental risks such as historic contamination are among the hardest risk issues to accurately quantify and manage, particularly in relation to projects with long concession periods.

The legal 'goalposts' are continually moving (especially in emerging markets) as regulatory frameworks evolve and the full extent of the exposure may not become clear until well after completion.

Flexible and competitive environmental risk transfer solutions can be used to:

– eliminate/ mitigate potential deal breakers and facilitate transactions
– add confidence to the provision/ acquisition of finance, thereby reducing debt service costs
– protect interested parties from environmental liability exposures/ negating the need for contingent reserves
– ensure clean exits for project lenders, owners, concessionaires, equity partners etc
– underpin contractual responsibilities such as warranties and indemnities
– cover consequential losses under a PPP/PFI contract e.g. loss of revenue as a result of a contamination event.

The imaginative application of environmental insurance can add certainty to financial models, improve bids and deliver real tangible value.

Environmental Liability Insurance

Insurance can be arranged for project liabilities associated with all phases of the project - covering pre-existing contamination and/or operational risks after completion of the construction phase.

Historical cover is typically provided for both third party property damage and bodily injury claims (e.g. resulting from off-site pollution migration) and unknown on-site and off-site clean up costs.

It is possible to augment environmental policies and cover contingent risks such as start up delays, business interruption or economic loss resulting from contamination.

Policies can also be structured to repay the outstanding loan balance or replace revenues/government funding in the event of the enforced shut down of an operational plant or facility for environmental reasons.
Policies can be worded so that they are fully transferable and jointly insure various parties (e.g. borrower and financier). Coverage can be designed and placed in extremely tight timescales.

Liability Capping
Due diligence exercises often identify 'known liabilities' such as the need for a remediation exercise or a capital investment programme.

Cost estimates for such issues are notoriously inaccurate, potentially leading to cost overruns. Significant exceedances could jeopardise the viability of the proposed project and these concerns often cause financial institutions to adopt an unusually cautious approach to lending where deals involve a major remediation programme.

Insurance mechanisms can be designed to remove this risk by providing the funds to complete such works in the event of a cost overrun.

Case Study
A UK PFI project entailed the provision of a fully integrated waste management system in the Midlands. The project included the construction of various waste reclamation facilities, the construction of a 10 MW waste to energy plant, and the operation and expansion of the waste management facilities for a 25 year concession period. The contractual structure of the deal required the successful bidder to accept responsibility for all the environmental liabilities associated with the operational landfills.

On behalf of the international consortium which won the contract, Willis negotiated a 10-year environmental policy, with a £10 million limit of indemnity, to cover historical contamination risks and ongoing pollution risks associated with both the construction and operational phases. The coverage provided reassurance for the project lenders hence unlocking the deal.

“Environmental policies can cover contingent risks such as start up delays”

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