

## 24 INSURANCE

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### 24.1 INTRODUCTION

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24.1.1 Traditionally, central government has chosen not to take out commercial insurance against insurable risks retained under conventional procurement techniques, as the premiums payable have not been seen to represent good value for money compared to self-insurance.

24.1.2 Local Authorities and other public bodies sometimes elect to insure some of their assets in the commercial insurance market, though typically this is with very high deductibles and a significant level of self insurance.

24.1.3 The position is different under PFI, because insurable risks are transferred to the Contractor which may have limited free financial resources, particularly if it is a special-purpose vehicle. Moreover, the need to ensure continuity of service means that self-insurance by such a Contractor for the full range of insurable risks is, generally, not appropriate. The Senior Lenders will usually take the same view and not expect nor wish the Contractor to self-insure. To achieve an acceptable credit quality for their loans, Senior Lenders will, in fact, frequently require more extensive insurance cover for the Contractor than that required by the Authority. Nonetheless, the Authority should not rely on the Senior Lenders to look after the Authority's own insurance interests, in this respect, and it is essential for the Authority to seek professional insurance advice on what insurance requirements should be imposed on the Contractor at an early stage in the procurement process (before issuing the ITN) and during subsequent negotiations.

24.1.4 The main issues which the Authority will need to consider with its insurance advisers are:

- whether and the extent to which the Authority should require the Contractor to take out and maintain certain insurances as a means of managing particular risks (see Clause 24.2.1 and Section 24.11), and how these may change over time (see Section 24.2.5 and Section 24.5). A detailed Standard Required Insurance Schedule is set out in Annex 5;
- ensuring that the proceeds of any claim under any required insurance are used correctly by the Contractor (see Section 24.6);
- Authority control of litigation where the Contractor is the principal party insured (see Section 24.7);
- whether the Authority should share significant increases and decreases in the market-wide cost of maintaining the Contractor's operating period insurances (see Section 24.8);
- what should happen if a risk for which insurance is to be effected and maintained in accordance with the required insurance schedule in the Contract becomes uninsurable (see Section 24.9);
- what should happen if any required insurance term becomes unavailable (see Section 24.10).

Insurance lies at the heart of the Contractor's risk management strategy and, in turn, efficient risk management lies at the heart of the value for money benefits of PFI that derive from long term

asset ownership and stewardship by investors. The Contractor's approach to insurance is inseparable from its approach to asset design, construction, choice of materials and maintenance regimes etc. Accordingly, Authorities and their advisers should take care not to disturb the transfer of this integral package of risks, nor to disturb incentives that ensure these risks are efficiently priced and managed. **Moreover it is essential that the Authority's insurance requirements and associated contractual provisions are clearly stated in the ITN and that bidders are required to price these matters within their responses to the ITN.**

24.1.5 The Authority's insurance requirements in Clause 24.2 and Annex 5 will represent a minimum degree of cover which the Authority expects to see maintained by the Contractor. It is, of course, for the Contractor to determine the overall insurance programme to be implemented, consistent with the Authority's and Senior Lenders' respective requirements. To ensure delivery of value for money, the Contract should incentivise (or, as appropriate, require) the Contractor at all times to:

- ensure full integration between the insurance programme and their overall risk management strategy<sup>1</sup>;
- make cost-effective trade-offs between lower deductibles and increased insurance premiums (within the constraints specified by the Authority and Senior Lenders);
- procure insurance from good quality and cost-effective suppliers; and
- look only to the Authority for cover in relation to unavailability of insurances as a last resort.

Under exceptional circumstances it may not be value for money for the private sector to bear all the risks associated with placing an insurance programme itself (e.g. in the event of (i) non availability of insurance or (ii) excessive market wide increases in insurance costs) and it is likely to be better value for money if an Authority provides a limited level of protection under specific circumstances (see Section 24.9 (Uninsurability) and Section 24.8 (Insurance Premium Risk Sharing)). Factors which should incentivise the Contractor to manage risks effectively and discourage the Contractor from seeking protection from the Authority, unless in exceptional circumstances and as a last resort, include the following:-

- the Contractor remains liable for deductible related losses;
- in the event of uninsurability and an uninsured risk materialising, the Authority may have the ability to terminate the Contract; and furthermore, the amount payable by the Authority to the Contractor upon such termination will be the same as that payable upon termination in the event of Force Majeure (i.e. equity payment limited to par value less Distributions paid to date (see Section 20.3)); and
- in respect of the operating period insurance premium risk sharing arrangement, protection is limited to general market wide changes in insurance costs. Furthermore the Contractor takes the first 30% of any relevant change in insurance cost, as well as 15% of any relevant change in insurance cost in excess of 30%.

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<sup>1</sup> For example, for a schools project, a Contractor should consider whether sprinklers should be installed, taking into account the lower cost of insurance which is likely to arise as a result.

## **24.2 AUTHORITY'S REQUIREMENTS**

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24.2.1 In general terms, the Contractor will be expected to insure in accordance with good industry practice.<sup>2</sup> However, in addition to the statutory insurances, there will be a number of required insurances which the Authority will want to know are being taken out and maintained by the Contractor, to ensure that insurance proceeds are available to cover certain types of claims. Such required insurances should include third-party liability insurance, contractors' 'all risks' insurance and property damage insurance during operation.

24.2.2 Only those risks which are to be covered by the Required Insurances and insurances required by law (see Clause 24.2(a) and (b)) will attract uninsurability protection (see Section 24.9). It is therefore important that apart from delay in start up and business interruption insurance (see Section 24.2.3 below), only those insurances from which the Authority derives a benefit as a co-insured party should be designated required insurances. Furthermore, in respect of those risks that the Contractor is required to insure against, the Authority should ensure that the uninsurability protection<sup>3</sup> does not extend to cover risks if it would have the effect of undermining the essence of the commercial principle that the risk being covered is a risk that the Contractor is required to manage. For example, if professional indemnity insurance or non-vitiation<sup>4</sup> protection become unavailable, the Authority should not provide such cover since it would insure the Contractor against claims relating to the Contractor's (or its sub-contractors') negligence. Authorities should therefore ensure that any professional indemnity insurance does not feature as a Required Insurance and non-vitiation protection is carved out of the uninsurability protection provided under Clause 24.9.

24.2.3 The Senior Lenders will require the Contractor to take out delay in start-up and business interruption insurance. The effect of these insurances is to ensure that during any period of reinstatement of physical damage to the Project, the Contractor will be able to meet its unavoidable running costs and fund debt service obligations on its Senior Debt. If such insurances become unavailable in the market and material damage to the Project subsequently arises, the Contractor may (depending on the period of reinstatement) default under the terms of the Senior Financing Agreements. Without the benefit of uninsurability protection for delay in start-up and business interruption insurances,<sup>5</sup> Senior Lenders are likely to require contingencies to be put in place by the Contractor to cover such eventualities. It is thus preferable that the Authority should, on value for money grounds, extend uninsurability protection in the Contract to cover business interruption insurance and delay in start-up insurance,<sup>6</sup> but this should exclude protection for Distributions. The Authority may be named as an additional insured under these two policies to the extent that it too has a demonstrable insurable interest. This is likely to be limited to any additional increase in the cost of working further to a loss which may form part of the cover, and will not extend to loss of revenue. It is important to remember that delay in start-up and business interruption insurances only respond in circumstances where an underlying policy covering material damage to the Project also responds, or would have responded in the case that this cover is also unavailable.

24.2.4 Insurance requirements should reflect the degree of risk transfer, the ability of the Contractor to make the premium payments (relative to the size of the risks), value for money considerations and the specifics of the Project. There are, of course, standard insurances that are required during the construction and operating phases of all projects, although the full scope of cover (e.g. the insured risks, the exclusions, the endorsements, the amounts of cover and the

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<sup>2</sup> What constitutes good industry practice should be part of the advice sought by the Authority from its professional insurance adviser (see Section 24.1.3 above).

<sup>3</sup> See Section 24.9 (Risks that become Uninsurable) below.

<sup>4</sup> See Section 24.2.9 below.

<sup>5</sup> See footnote 59 below.

<sup>6</sup> This is sometimes referred to as advanced loss of profits insurance (ALOP).

deductibles) will vary from project to project and from sector to sector.<sup>7</sup> Whilst the construction phase insurances typically cover the whole of the construction phase, the operational insurance are renewed periodically (mostly annually). It is important that the renewal process starts well in advance of the renewal date.

24.2.5 Insurers should inform the Authority of changes in the policy.

24.2.6 If the Authority wishes to increase the limits or scope of the insurances during the life of the Contract, then this should be treated as an Authority Change (see Section 12.3 (Authority Changes)).

24.2.7 As central Government generally self-insures, there should be no requirement for insurances to cover those risks retained under the Project by a central Government Authority. It is, however, reasonable to seek third-party public liability insurance where appropriate (this should be checked with the relevant policy unit within the Authority).

24.2.8 The Authority should protect its position by being a co-insured for its own interests (where it has an insurable interest) and requiring its interests to be noted as appropriate on the insurances taken out by the Contractor. This should be acceptable to the Contractor.<sup>8</sup>

24.2.9 The Authority should consider the value for money benefits of requiring the Contractor to take out “non-vitiation” protection in respect of certain required insurances. Non-vitiation protection allows the Authority to claim as a co-insured under a policy even if the insurer would be able to avoid a claim made by the Contractor on the basis that the Contractor, for example, withheld material information from the insurer (e.g. the Contractor does not make the insurer aware that it is intending to use highly flammable substances during the construction period). The Senior Lenders may also require non-vitiation cover. However, absence of such cover shall not be covered by the uninsurability protection given to the Contractor in respect of unavailability of insurance cover.<sup>9</sup>

Suitable drafting is as follows:

## 24.2 Insurance

- (a) The Contractor shall, prior to the Service Commencement Date, take out and maintain or procure the maintenance of the insurances described in Part 1 of Annex 5 (Required Insurances) and any other insurances as may be required by law. These insurances must be effective in each case not later than the date on which the relevant risk commences.<sup>10</sup>
- (b) The Contractor shall during the Service Period take out and maintain or procure the maintenance of the insurances described in Part 2 of Annex 5 (Required Insurances) and any other insurances as may be required by law.<sup>11</sup>
- (c) No party to this Contract shall take any action or fail to take any reasonable action, or (insofar as it is reasonably within its power) permit anything to occur in relation to it, which would entitle any insurer to refuse to pay any claim under any

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<sup>7</sup> Salient information as to the scope of the required insurances specified in Section 24.2.1 should be included within the Standard Required Insurance Schedule to the Contract (see Section 24.11 below).

<sup>8</sup> Where possible, the Authority should be a co-insured on the Contractor's insurance policies. This is a much stronger position for the Authority than being named as “loss payee” under the policy, as a co-insured can make the claim itself and is not (as in the case of a “loss payee”) reliant on the insured party making the claim.

<sup>9</sup> See Section 24.9 (Risks that become Uninsurable).

<sup>10</sup> These are the construction or development phase insurances and must be required insurances only. The insurance schedule should specify the dates by which these insurances should be effective.

<sup>11</sup> These are the operational insurances and must be necessary insurances only. In some projects the operational phase may overlap with the construction phase (e.g. a grouped schools project) and insurance requirements will need to be tailored accordingly.

insurance policy in which that party is an insured, a co-insured or additional insured person.

- (d) The insurances referred to in paragraphs (a) and (b) shall:
- (i) subject to paragraph (e) below, name the Contractor as co-insured with any other party maintaining the insurance;
  - (ii) [provide for non-vitiating protection in respect of any claim made by the Authority as co-insured in accordance with Endorsement [2] in Part 3 of [Annex 5];
  - (iii) contain a clause waiving the insurers' subrogation rights against the Authority, its employees and agents in accordance with Endorsement [2] in Part 3 of [Annex 5];
  - (iv) provide for 30 days prior written notice of their cancellation, non-renewal or amendment to be given to the Authority<sup>12</sup> in accordance with Endorsement [1] in Part 3 of [Annex 5]; and
  - (v) in respect of the Physical Damage Policies provide for payment of any proceeds received by the Contractor to be applied in accordance with Clause 24.5 (Reinstatement).
- (e) Wherever possible, the insurances referred to in paragraphs (a) and (b) shall name the Authority as a co-insured for its separate interest.<sup>13</sup>
- (f) The Contractor shall provide to the Authority:
- (i) copies on request of all insurance policies referred to in paragraphs (a) and (b) (together with any other information reasonably requested by the Authority relating to such insurance policies) and the Authority shall be entitled to inspect them during ordinary business hours; and
  - (ii) evidence that the premiums payable under all insurance policies have been paid and that the insurances are in full force and effect in accordance with the requirements of this Clause 24.2 (Insurance) and Annex 5 (Required Insurances).
- (g) Renewal certificates in relation to the insurances referred to in paragraphs (a) and (b) shall be obtained as and when necessary and copies (certified in a manner acceptable to the Authority) shall be forwarded to the Authority as soon as possible but in any event on or before the renewal date.
- (h) If the Contractor is in breach of paragraphs (a) or (b) above, the Authority may pay any premiums required to keep such insurance in force or itself procure such insurance and may in either case recover such amounts from the Contractor on written demand.<sup>14</sup>
- (i) The Contractor shall give the Authority notification within 30 days after any claim in excess of £[ ] on any of the insurance policies referred to in this Clause accompanied by full details of the incident giving rise to the claim.<sup>15</sup>

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<sup>12</sup> To the extent that the Authority has an insurable interest.

<sup>13</sup> This will only be possible for policies in which the Authority has an insurable interest (not, for example, professional indemnity insurance) or where the policy has an "indemnity to principals" provision (for example, in an employers liability insurance).

<sup>14</sup> These amounts can be set off under Clause 11 (Set-Off).

<sup>15</sup> On projects on which many claims are expected, the Authority can agree a minimum amount below which it is not notified. If this is done, it may be necessary for the Authority to be notified of important claims (e.g. accident and injury based claims).

- (j) Neither failure to comply nor full compliance with the insurance provisions of this Contract shall limit or relieve the Contractor of its liabilities and obligations under this Contract.
- (k) The insurance premiums in respect of the insurances referred to in paragraphs (a) and (b) shall be the responsibility of the Contractor.

### **24.3 MECHANISM TO INCREASE INSURED AMOUNTS**

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24.3.1 It is generally not possible to place insurance to cover the full life of a Contract, although a single policy to cover a construction phase (extending over several years) can usually be arranged. By contrast, policies covering the operational phases of projects are generally renewable annually. In this case, where policies are renewable annually, there needs to be a mechanism to ensure that the insured amounts and deductibles specified in the schedule of required insurances increase over the duration of the Contract in order to keep pace with inflation.<sup>16</sup> This is commonly done through an index-linking mechanism. Alternatively, it may be by agreement on expiry and renewal of policies.

24.3.2 Index-linking can cause a problem for liability insurance if it cannot be bought in odd amounts (e.g. £50, £51.15, £52.53 etc) although this is normally dealt with by rounding up annually to the nearest whole insurable amount.

24.3.3 The risk of increases and decreases in insurance costs should be borne primarily by the Contractor.<sup>17</sup> Whilst there may ultimately be indirect protection (e.g. via indexation(see Section 14.2 (Indexation)), the Contract should not include any provisions which expose the Authority to direct pass-through of such extra costs, save as described in Sections 24.8 (Insurance Premium Risk Sharing) and 24.9 (Risks That Become Uninsurable). Increases or decreases in insurance premiums which result from Authority Changes (see Section 12.3 (Authority Changes)) should be taken into account in any price variations resulting from the change in Service. The Contractor should bear any premium increases resulting from any change in Service it proposes (see Section 12.5 (Contractor Generated Changes in Service)).

24.3.4 In no circumstances should the Authority introduce benchmarking of insurance provisions into the Contract, or any other arrangements which have the same commercial effect. The appropriate price protection mechanism is set out in Section 24.8 below. This will operate in addition to the uninsurability protection set out in Section 24.9.

### **24.4 ENSURING THE QUALITY OF THE INSURANCES**

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24.4.1 The Contract should require that all insurances are placed through a reputable insurer of good standing. In practice, financiers will ensure that insurances will be arranged by, and placed with brokers and insurers approved by them (or that fall within a particular category) and on terms acceptable to them.

24.4.2 There is usually no need to limit the market within which the Contractor must insure the relevant risks (e.g. the worldwide market is not unusual).

Suitable drafting is as follows:

The insurances referred to in this Clause shall be effected with insurers approved by the Authority, such approval not to be unreasonably withheld or delayed.

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<sup>16</sup> This will not be necessary where the insured amount is an unspecified amount (e.g. the reinstatement cost of a property) rather than a specific sum (as is usually the case for third party liability cover).

<sup>17</sup> This risk relates not only to increased premiums but also to increased levels of deductibles. See Section 24.9.1.

## **24.5 REINSTATEMENT AND CHANGE OF REQUIREMENT AFTER INSURED EVENT**

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24.5.1 If an insured event occurs and certain Assets require replacement or reinstatement, the Authority may decide to change the service requirement. If it does so, the cost of reinstatement may be more or less than the cost of exact replacement. Clearly there is no problem where the cost is less. Where insurance proceeds do not cover the full reinstatement, and the additional cost is due to an Authority Change (and not under-insurance by the Contractor of the original asset), then the extra cost must be funded by the Authority in accordance with the change in Service mechanism (see Section 12.3 (Authority Change)).

24.5.2 Although insurance should be available for full reinstatement, the Contractor should nonetheless arrange cover on terms which reflect the fact that the Authority's requirements may change after an insured event occurs and that it is possible that there will be a requirement for something other than full or exact reinstatement.<sup>18</sup>

24.5.3 In practice, the parties are likely to discuss and negotiate whether (and how) to reinstate the Project after the occurrence of an insured event. Accordingly, the Contract should set out provisions regarding how the parties will agree a plan for the reinstatement of the project ("Reinstatement Plan"). The Contract must be clear as to the remedy in the event of disputes over reinstatement. The Authority should be aware that following any physical damage to the Project, the Contractor will only be permitted to claim under the delay in start up and business interruption insurances if the insurer is satisfied that the Contractor is using its reasonable endeavours to reinstate. Accordingly, the Authority's response to the proposed Reinstatement Plan should be reviewed by the Authority as a matter of priority and the Authority should respond to the Contractor within a reasonable period of time.

24.5.4 The Authority has a clear interest in the application of any insurance proceeds received by the Contractor under the physical damage policies that are to be applied in reinstatement of the Project. Although the Authority agrees a Reinstatement Plan with the Contractor, the Authority should also be concerned to ensure that any insurance proceeds are utilised in accordance with the agreed Reinstatement Plan. Additionally, the Authority must ensure that upon termination of the Contract (either through natural expiry or early termination) the Authority receives the benefit of any insurance proceeds so that it can continue with the reinstatement of the Project.<sup>19</sup> This is achieved by having the insurance proceeds in excess of a minimum level paid into a joint insurance account which is in the names of the Authority and the Contractor<sup>20</sup>. Proceeds below the minimum level are paid directly to the claimant (with the exception of third party liability claims payments which are typically paid directly to the aggrieved party). A minimum level is set in order to avoid unnecessary administrative costs arising.

Required drafting is as follows:

### **24.5 Reinstatement**

- (a) [Subject to Clause 24.6 (Economic Test)], all insurance proceeds received under any policy referred to in paragraph 1 of Parts 1 and 2 of Annex 5 (the "Physical Damage Policies")<sup>21</sup> shall be applied to repair, reinstate and replace each part or parts of the Assets in respect of which the proceeds were received.

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<sup>18</sup> If the Authority decides to reinstate with a lower level of Service requirement following an insured event, the Unitary Charge should remain the same unless compensation is paid to the Contractor. The Authority should also be aware of the fact that a decision not to reinstate fully may impact upon the amount of insurance proceeds recoverable.

<sup>19</sup> This is particularly important if the Contract is terminated for Contractor Default and the Authority elects (and is able) to retender the Contract.

<sup>20</sup> To note that insurers generally settle as the costs of reinstatement are incurred and so large balances seldom build up in the joint insurance account.

<sup>21</sup> This will not include, for example, third party liability, employers' liability, business interruption or advance loss of profits insurance.

- (b) All insurance proceeds paid under any Physical Damage Policy in respect of a single event (or a series of related events) in an amount in excess of £ [minimum level] (indexed) shall be paid into the Joint Insurance Account.<sup>22</sup>
- (c) [Subject to Clause 24.6 (Economic Test)], where a claim is made or proceeds of insurance are received or are receivable under any Physical Damage Policy in respect of a single event (or a series of related events) (the (“Relevant Incident”) in an amount in excess of £ [the same figure as in paragraph (b) above] (Indexed):
  - (i) the Contractor shall deliver as soon as practicable and in any event within [28] days after the making of the claim a plan prepared by the Contractor for the carrying out of the works necessary (the “**Reinstatement Works**”) to repair, reinstate or replace (the “**Reinstatement Plan**”) the assets which are the subject of the relevant claim or claims in accordance with paragraph (d) below. The Reinstatement Plan shall set out:
    - (A) if not the Construction Sub-contractor, the identity of the person proposed to effect the Reinstatement Works, which shall be subject to the prior written approval of the Authority; and
    - (B) the proposed terms and timetable upon which the Reinstatement Works are to be effected (including the date that the Project will become fully operational), the final terms of which shall be subject to the prior written approval of the Authority, which approval shall not be unreasonably delayed;
  - (ii) provided that the Authority is satisfied that the Reinstatement Plan will enable the Contractor to comply with paragraph (d) below within a reasonable timescale:
    - (A) the Reinstatement Plan will be adopted;
    - (B) the Contractor shall enter into contractual arrangements to effect the Reinstatement Works with the person identified in the Reinstatement Plan approved by the Authority;
    - (C) prior to the earlier to occur of the Termination Date or the Expiry Date, any amounts standing to the credit of the Joint Insurance Account (the “**Relevant Proceeds**”) (together with any interest accrued) may be withdrawn by the Contractor from the Joint Insurance Account as required to enable it to make payments in accordance with the terms of the contractual arrangements referred to in paragraph (ii)(B) above, and to meet any other reasonable costs and expenses of the Contractor for the sole purposes of funding the Reinstatement Works and the parties shall operate the signatory requirements of the Joint Insurance Account in order to give effect to such payments. Following the earlier to occur of the Termination Date and the Expiry Date, the Authority may withdraw amounts standing to the credit of the Joint Insurance Account for the purposes of funding any Reinstatement Works;
    - (D) the Authority agrees and undertakes that, subject to compliance by the Contractor with its obligations under this clause, and provided that the Contractor procures that the Reinstatement Works are carried out and completed in accordance with the contractual arrangements referred to in paragraph (ii) (B), it shall not exercise any right which it might otherwise have to terminate

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<sup>22</sup> See Section 1.8 (Interpretation) for definition.

this Contract by virtue of the event which gave rise to the claim for the Relevant Proceeds;<sup>23</sup>

- (E) the Authority undertakes to use reasonable endeavours to assist the Contractor in the carrying out of the Reinstatement Plan; and
  - (F) after the Reinstatement Plan has been implemented to the reasonable satisfaction of the Authority and in accordance with paragraph (d) below the Authority shall permit withdrawal by the Contractor of any Relevant Proceeds then held in the Joint Insurance Account that have not been paid under paragraph (ii) (C) above, in respect of the Relevant Incident, together with any interest accrued.
  - (G) subject to the provisions of Clause 23.3.8 the Contractor shall be solely responsible for the payment of any deficiency.
- (d) Where insurance proceeds are to be used, in accordance with this Contract, to repair, reinstate or replace any Asset, the Contractor shall carry out the work in accordance with the [Construction Specification] so that on completion of the work, the provisions of the Contract are complied with.

## **24.6 APPLICATION OF INSURANCE PROCEEDS**

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24.6.1 The Contractor should always be obliged to reinstate the asset and the Service if an insured event occurs. If the Authority does not require reinstatement, then any insurance proceeds should go to the Contractor but the Authority should be aware that this effectively results in a voluntary termination and the Authority will be obliged to make a full payout to the Contractor (see Section 20.5 (Voluntary Termination)), but deducting such amounts from the payment.

24.6.2 In some projects, Senior Lenders may want to impose a project economic test to determine whether reinstatement will enable them to recover their outstanding debt in full. If the economic test shows that this is not possible, Senior Lenders prefer to appropriate the insurance proceeds instead of allowing reinstatement. This should not be a first resort for the Senior Lenders and there should be good reasons for the Authority to agree to the inclusion of an economic reinstatement test in the Contract. Senior Lenders should focus instead on ensuring that the amounts insured under the delay in start up and business interruption insurances are sufficiently high, or that there is sufficient contingency in the Contractor's finances to deal with their concerns.

24.6.3 A project economic test should not be necessary where there is a low risk of total destruction of the asset (such as with a road or rail project, or a project that has a number of geographically diverse sites). Where the risk exists (e.g. a single-site project), the Authority may accept a project economic test but this should be based on the default senior loan life cover ratio so that Senior Lenders cannot abandon the Project if the test shows that debt service is achievable (even if there is a minimal amount of headroom). Including annual debt service cover ratios in an economic test is not recommended (as these ratios give only an annual "snapshot" of performance, which is not relevant here). There should be no need to specify a threshold amount of insurance proceeds below which the economic test should not be applied because the test should in any event only be applied in cases of total or near total destruction.

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<sup>23</sup> This would apply if the definition of Relief Events (see Section 5.3.2 (Scope of Relief Events)) did not cover the insured event giving rise to the issue of reinstatement. If so, the Contract may confirm that the concepts of Compensation Events and Relief Events (see Section 5 (Delays)) will apply during the period of carrying out the Reinstatement Works so that, for example, any Authority breach will be treated as a Compensation Event (see Section 5.2.1.2) during this period.

24.6.4 If the result of the project economic test allows the Senior Lenders to appropriate the insurance proceeds or an amount equal to the outstanding Senior Debt (whichever is the lesser), the Contractor remains under an obligation to reinstate the asset. If, as is likely, it is not financially able to do so, it will be in breach of contract and the Authority will terminate for Contractor Default in the usual way (see Section 20.2 (Termination for Contractor Default)). The Authority can then rebuild the asset through a new competition.

Where an economic reinstatement test is used the following is the required drafting:

#### **24.6 Economic Test**

- (a) If all of the Assets are destroyed or substantially destroyed in a single event and the insurance proceeds (when taken together with any other funds available to the Contractor<sup>24</sup>) are equal to or greater than the amount required to repair or reinstate the Assets, then the Contractor<sup>25</sup> shall calculate<sup>26</sup> the senior debt loan life cover ratio<sup>27</sup> as used in the Base Case (on the assumption that the Assets are repaired or reinstated in accordance with Clause 24.5(c)).
- (b) If the calculation referred to in paragraph (a) above shows that the senior debt loan life cover ratio is greater than or equal to [event of default level] then the Contractor shall be subject to the procedure set out in Clause 24.5 (Reinstatement).
- (c) If the calculation referred to in paragraph (a) above shows that the senior debt loan life cover ratio is less than [event of default level] then an amount equal to the lesser of:
  - (i) the insurance proceeds; and
  - (ii) the Base Senior Debt Termination Amount, or, if any Additional Permitted Borrowing has been advanced, the Revised Senior Debt Termination Amount,<sup>28</sup>shall be released from the Joint Insurance Account to the Contractor.<sup>29</sup>
- (d) If, pursuant to paragraph (c) above, insurance proceeds are released from the Joint Insurance Account the Contractor shall be in breach of its obligations under this Contract and shall not, pursuant to Clause 5.3 (Relief Events), be relieved of its obligations unless it can demonstrate, to the satisfaction of the Authority, that it can carry out the works necessary to repair, reinstate or replace the assets which are subject to the relevant claims in accordance with Clause 24.5(d) (Reinstatement) and within a reasonable timescale.

#### **24.7 CONTROL OF THE DEFENCE ON LITIGATION OF AN INSURED EVENT**

24.7.1 The Authority may wish to control the defence of any litigation against the Contractor which is likely to have implications for the Authority itself or wider Government. If the Authority is likely to become a co-defendant in the relevant litigation or a defendant in a number of similar litigations which will be based on the precedent in law set by the relevant litigation, it is likely to

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<sup>24</sup> Such funds could, for example, include sums made available to the Contractor by the Authority to ensure that the test in paragraph (b) is passed and that, as a result, reinstatement occurs in accordance with Clause 24.5 (Reinstatement).

<sup>25</sup> The calculation will be controlled by the Senior Lenders in the Financing Agreements, and checks will need to be made by the Authority that this calculation allows reinstatement.

<sup>26</sup> There will be a debate as to how this should be done. Since the Senior Lenders are those whose interests are being protected, the formulae set out in the banking financial model should be used, having agreed exactly how the formula will work and memorialised this in the Contract (see footnote 25 above).

<sup>27</sup> For the meaning of this ratio see Section 5.2.3 (Calculation of Compensation).

<sup>28</sup> As set out in the relevant definition, excluded from this will be amounts standing to the credit of the Joint Insurance Account.

<sup>29</sup> This will mean the amounts are released to the accounts secured to Senior Lenders and the Senior Lenders will apply such amounts as a prepayment against Senior Debt.

want to control the litigation from an early stage. This may involve prolonging litigation in order to establish a clear precedent instead of settling out of court. Alternatively, the Authority may wish to settle the litigation as soon as possible for public policy reasons and, in such cases, these will override commercial considerations (this may be the case, for example, in prison and hospital projects).

24.7.2 The Contractor's insurer will usually expect to be in control of any litigation which may lead to a claim under one of its policies. It will be reluctant to pay out for claims over which it has had no control of the defence. This might include claims which the Authority has settled out of court where the courts may have awarded a lesser amount had the action been fully pursued or claims which the insurer believes it could have settled out of court for a lesser amount than is awarded by the courts. The degree of control by the Authority which the insurer will accept should be examined on a project-specific basis.

24.7.3 Generally, the Authority should expect to take back some liability for litigation costs if it wishes to insist on controlling such litigation. In practice, it is extremely difficult to determine what such liability should be. In principle, the Authority should be liable for any difference between what the insurer would have paid and the final amount settled or decided. It would be very hard to establish, however, what amount would have been an acceptable settlement to all parties (including the plaintiff) in either case outlined in Section 24.7.2. In practice, the Authority may find it is obliged to take on the majority, or even all, of the relevant litigation costs in return for the right to control the defence.

## **24.8 INSURANCE PREMIUM RISK SHARING SCHEDULE**

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**24.8.1** An Authority may elect to provide some protection to the Contractor for changes in the market wide costs of maintaining operational phase insurances. The Authority will need to form a view as to the extent to which this will improve value for money. In projects where the Contractor retains end user risk, the Authority should consider whether it should give the Contractor any price protection in relation to increases in insurance premiums, as the Contractor may be able to manage such increases by increasing the price that the end user pays for the Services. **If the Authority decides to provide such protection, the Insurance Premium Risk Sharing Schedule ("IPRSS") (see Schedule A below) is the *only* mechanic which should be used and is required drafting.**

**24.8.2** If an Authority elects to provide relief for changes in insurance costs the IPRSS should be included in the ITN documentation, and agreed by the relevant party prior to award of preferred bidder status. The appointment of a preferred bidder will typically occur a few months prior to Financial Close. **The Base Cost against which changes are measured must be agreed between the Authority (in conjunction with its insurance adviser) and the bidder, prior to the preferred bidder status being awarded (See Chapter 33 Commitment Letters). There should normally be no variation to the modelled insurance premium assumptions after the appointment of a preferred bidder.** Only in the event of either

- (i) a significant project scope change between BAFO stage and financial close which has a material impact on projected insurance premiums; or
- (ii) a delay in financial close beyond the expected financial close date resulting in an increase in the construction price and giving rise to a legitimate change in the relevant sum(s) insured

should the bid Base Cost be allowed to vary after the Contractor has been awarded preferred bidder status. The Base Cost should be set at a *long run* median level, such that the probabilities of the outturn costs being higher or lower in the future (after adjusting for RPI inflation) are the same. This will invariably differ from the prevailing cost of insurance at the Bid Date. Authorities

and their advisers must take care to avoid accepting artificially depressed Base Cost figures which will underestimate the outturn unitary charge payment profile and simply lead to the Authority paying compensation above the upper 30% threshold during the Contract term. Conversely, they should not rely on the sharing of future cost reductions, below the lower 30% threshold, as justification for an overestimated Base Cost still representing value for money.

**24.8.3** As stated in 24.3.3, the risk of increases in insurance costs should lie primarily with the Contractor. However it may not be value for money for the Authority to require the Contractor to take on the full risk of exceptional market wide movements in operational phase insurance costs: the issue here is similar to that on uninsurability (see Section 24.2.3). Senior Lenders may require the Contractor to establish large reserves against such risks (or increase the Unitary Charge to cover them), whereas if these exceptional risks are taken by the Authority, this may offer better value for money. However, if the Authority takes on the risk of exceptional upward movements in market wide insurance costs, it should also receive a corresponding benefit from reductions.

**24.8.4** Authorities may, therefore, agree that if there is a movement of more than 30% in the projected operational insurance costs on account of market wide factors, any excess will be shared 85% to the Authority and 15% to the Contractor. Leaving this 15% risk with the Contractor will ensure that, in the event of such an exceptional increase, the Contractor will remain incentivised and focused on seeking to reduce premiums at each renewal. (It should be noted that the Contractor's liability will nonetheless be limited given the uninsurability protection available should insurance no longer be available on a commercially viable basis (see Section 24.9 and Clause 24.9.3(b)).

**24.8.5** Authorities should benefit correspondingly from 85% of any falls in general market insurance costs in excess of a 30% reduction in the projected operational phase insurance costs.

**24.8.6** This insurance cost sharing arrangement is limited to market wide movements and so should not take into account the following:-

- Any change in the cost of insurance which, with the exception of portfolio cost savings, is not attributable to a general movement in insurance costs across the PFI market as a whole, (i.e. changes in insurance costs due to circumstances generally prevailing in the insurance market in which insurance for the majority of all PFI projects (across all of the sectors) is placed). Accordingly changes in insurance costs which are project or sector-specific should not be taken into account.<sup>30</sup>;
- changes in insurance premium tax<sup>31</sup>;
- changes in insurance intermediaries' fees and commissions.

**24.8.7** As the PFI market matures and becomes less fragmented, Contractors who may have set the modelled cost of insurance on the basis of a single project placement may, during the course of the operational phase of the Project, elect to effect insurance on a portfolio basis (i.e. under a policy also covering risks on other projects or other matters which are outside the scope of the Project). This may give rise to significant cost savings (Portfolio Cost Savings). Given the level of risk which the Authority is assuming, it is considered reasonable for the Authority to potentially benefit from this approach: Accordingly, in the event that there are any insurance cost savings from portfolio placements, for the purpose of determining the Project Insurance Change and Insurance Cost Differential (see Schedule [A] (Insurance Premium Risk Sharing Schedule)), such savings should be considered in the same way as other factors causing a general market

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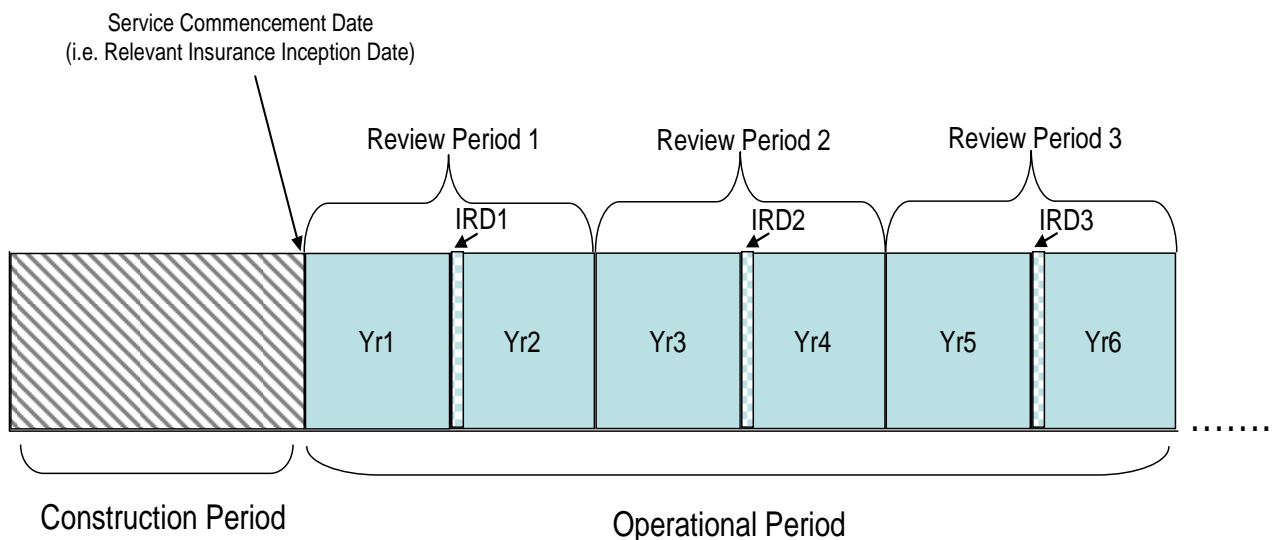
<sup>30</sup> This therefore includes changes in insurance costs attributable to the actions of the Contractor, which should not be taken into account given the correlation between Contractor performance and insurance premiums.

<sup>31</sup> Insurance premium tax is considered a commercial risk for the Contractor in the same way as Corporation Tax.

movement in insurance costs. Therefore, the actual cost of insurance is not adjusted to reflect what the cost of insurance would have been in the absence of such savings.

**24.8.8** Whilst effecting insurance on a portfolio basis may lead to significant cost savings on an aggregated basis, it is possible that the position on an individual project within the proposed portfolio arrangement is undermined. Accordingly, an individual Authority should not be obliged to join a portfolio solution if the effect is to make it worse off.

**24.8.9** The cost-sharing calculations are to determine if any payments are to be made either by or to the Authority. This is based on a comparison of the relevant actual insurance cost with the relevant projected cost of insurance. With the exception of the first review, which should take place immediately after the first operational phase policy renewal, reviews of the actual insurance costs against the base projections, should take place biennially<sup>32</sup>. The cost of insurance for the previous year and the cost of insurance for the current year are assessed at each review. A diagrammatic representation of this is given below.



IRD = Insurance Review Date  
IRD1 = First Insurance Review Date

**24.8.10** . The renewal process will be transparent, enforceable and supported by evidence. At each review date, an insurance cost report should be provided by the Contractor's insurance broker on behalf of both the Contractor and the Authority (as joint assured). This will be at the Contractor's cost. This should, inter alia, provide an assessment of the reasons for the changes in insurance costs for each of the main insurance covers and state the level of variation between the Base Cost and the actual insurance costs. (The bidder's financial model should contain a detailed breakdown of all insurance related costs in order to ensure transparency, including, but not limited to, the projected cost of each Relevant Insurance, insurance premium tax and brokers' fees and commissions).

<sup>32</sup> The insurance market is cyclical and, arguably, if a period for aggregating insurance costs of, say, five years were used then there would be little need for the IPRSS. However, aggregating insurance costs over a period of several years can create working capital issues for Contractors and so a compromise period of two years has been chosen.

**24.8.11** For the cost sharing mechanic to operate effectively, there must be transparency, and the insurance costs assessment must be supported by appropriate evidence. When preparing the insurance cost report the broker should not only rely on the feedback from the insurance underwriter but should also refer to other suitable data sources, including the CBS Capital non marine index<sup>33</sup>. In addition PFI insurance cost data will be collated centrally by HM Treasury or its nominee and this will serve as an additional source of information. (When the report is submitted by the Contractor to the Authority, project insurance cost and deductible data for the relevant Insurance Review Period for each principal insurance cover is to be submitted to HM Treasury or its nominee. This is intended to facilitate the creation and maintenance of a PFI insurance cost database.)

**24.8.12** Given that the Authority is a joint insured and will be providing relief to the Contractor above a 30% threshold, a duty of care should be owed by the insurance broker to the Authority. Furthermore, given that the Authority will, to an extent, be relying on the findings in the insurance cost report when determining monies due, it is important that the insurance broker understands and commits to providing this duty of care to the Authority when preparing the Insurance Cost Report. Accordingly, the Brokers Letter of Undertaking should contain a duty of care undertaking in connection with the preparation of this report (see Clause 4.5 of Part 4 of Annex 5 (Brokers Letter of Undertaking)).

**24.8.13** In addition an Authority may wish to consider employing the services of an 'independent' insurance advisor to confirm the accuracy of the information in the insurance cost report and help generally in the renewal process. It is important that the insurance advisor is not affiliated with the insurance broker placing the insurances and producing the insurance cost report.

**24.8.14** If an insurance risk becomes uninsurable (see Section 24.9) or a term or condition is no longer available (see Section 24.10) the Base Cost (See 'Definitions' in Schedule [A] below) should be adjusted to reflect the reduced level of cover being procured. Where possible the level of adjustment should be determined by the amount included in the Base Cost attributable to the uninsurable risk. Likewise, in circumstances of the Authority providing uninsurability protection (see Section 24.9), the unitary charge payable will be reduced by the cost most recently incurred for the insurance cover that is no longer being purchased by the Contractor. In practice, it may be difficult to discern from the Financial Model the cost projected to be incurred for the uninsurable risk, in which case it should be determined predominantly by the amount payable in the previous period for the particular risk.

**24.8.15** It is not mandatory for an Authority to offer insurance premium risk sharing in the Contract. The decision on whether or not to do so must be taken in the light of the specific nature of the Project and a suitable value for money assessment. However, if the Authority does decide to offer insurance premium risk sharing, the only basis on which this may be included in the Contract is as set out in this Section 24.8.

The Contractor may in its pursuit of the best value for money for itself and the Authority wish to effect insurance for a period of in excess of one year, with insurance renewal taking place at intervals of in excess of 12 months. In this case, the Contractor should consult with the Authority before proceeding with the cover to ensure that both parties agree that it represents improved value for money.

If an Authority elects to share insurance cost risk, the required drafting is as follows (to be included as a schedule to the Contract):

### **Insurance Premium Risk Sharing Schedule (Schedule [A])**

#### **1 Definitions**

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<sup>33</sup> The CBSPC non marine index may be accessed via the following web address:-<http://www.cbs-loyds.co.uk/cgi-bin/mri/FileReader.pl>

1.1 For the purposes of this Schedule, the following words and expressions shall bear the following meanings:

**Actual Relevant Insurance Cost** means the aggregate of the [annual]<sup>34</sup> insurance premiums reasonably incurred by the Contractor to maintain the Relevant Insurance during the Insurance Review Period but excluding insurance premium tax and all broker's fees and commissions;

**Base Cost** means £ [ ] being the amount as agreed at the Bid Date<sup>35</sup> and set out in the Financial Model which represents the insurance costs (which excludes amounts in respect of insurance premium tax and all brokers' fees and commissions) which are proposed to be incurred to maintain the Relevant Insurance in each year following the Services Commencement Date, expressed in real terms as at the Bid Date;

**Base Relevant Insurance Cost** means, the aggregate of the Base Costs which were (at Bid Date) projected to be incurred to maintain the Relevant Insurance during the Insurance Review Period indexed by actual RPI from the Bid Date up to the dates on which the Relevant Insurance was placed or renewed either immediately before or during the Insurance Review Period (as applicable in respect of the year in question) less any Base Relevant Insurance Reduction;

**Base Relevant Insurance Reduction** the reduction to be made to the Base Relevant Insurance Cost in respect of a risk which has become Uninsurable or a term or condition which is no longer available and shall be an amount that is either:

- (a) the amount by which the Base Relevant Insurance Cost would have been a lesser amount had such a risk been Uninsurable or such a term or condition been unavailable at the Bid Date (which amount, for the avoidance of doubt, can be £0); or
- (b) if it is impossible to determine an amount pursuant to paragraph (a) above, an amount that is reasonable to be deducted from the Base Relevant Insurance Cost having due regard to:
  - (i) the amount by which the Actual Relevant Insurance Cost is less than it would have been as a result of the risk becoming Uninsurable, or the term or condition becoming unavailable (the "Actual Reduction");
  - (ii) the size of the Actual Reduction as a percentage of the Actual Relevant Insurance Cost immediately prior to the risk becoming Uninsurable, or the term or condition becoming unavailable; and
  - (iii) the effects of RPI since the Bid Date;

**Business Interruption Cover** shall bear the meaning ascribed to it in Schedule []

<sup>34</sup> This will depend on the frequency of payment of insurance premiums.

<sup>35</sup> The Bid Date is the date on which the Contractor has fixed its price prior to appointment as Preferred Bidder. The Base Cost in bidders' models should be set at a long run median level such that the probabilities of the outturn costs being higher or lower in the future (after adjusting for RPI inflation) are the same. This is to ensure that the approach is consistent with the symmetrical sharing of Insurance Cost Differentials (i.e. +/- 30% thresholds etc.). Furthermore, the median level should be held constant in real terms (year on year) and not profiled, as this will help to ensure that the symmetrical cost sharing band works as intended. Authorities and their advisers must take care to avoid accepting artificially depressed Base Cost figures which will underestimate the outturn unitary charge payment profile and simply lead to the Authority paying compensation above the upper 30% threshold during the Contract term. Conversely, they should not rely on the sharing of future cost reductions, below the lower 30% threshold, as justification for an overestimated Base Cost still representing value for money.

(Required Insurance Schedule<sup>36</sup>);

**Construction Period Insurance** means the Required Insurance in respect of the period from the date of this Contract to the Service Commencement Date;

**Contract Period** means the period from and including the date of this Contract to the Expiry Date, or if earlier, the Termination Date;

**Contractor Related Party** means the Contractor's agents and contractors (including without limitation the Construction Sub-contractor and the Operating Sub-contractor) and its or their subcontractors of any tier and its or their directors, officers, employees and workmen in relation to the Project and any person on or at any of the [sites] at the express or implied invitation of the Contractor (other than the Authority or any [Authority related party])<sup>37</sup>;

**Exceptional Cost** means, for an Insurance Review Period, the extent to which there is an Insurance Cost Increase which exceeds in amount 30% of the Base Relevant Insurance Cost for that Insurance Review Period;

**Exceptional Saving** means, for an Insurance Review Period, the extent to which there is an Insurance Cost Decrease which exceeds in amount 30% of the Base Relevant Insurance Cost for that Insurance Review Period;

**First Insurance Review Date** means the first Business Day following the first anniversary of the Relevant Insurance Inception Date,<sup>38</sup>

**Insurance Cost Decrease** means the Insurance Cost Differential if the value thereof is less than zero, multiplied by minus one<sup>39</sup>;

**Insurance Cost Differential** shall, subject to the Insurance Review Procedure, be determined as follows:-

$$\text{Insurance Cost Differential} = (\text{ARIC} - \text{BRIC}) - (\pm\text{PIC})^{40}$$

where:

ARIC is the Actual Relevant Insurance Cost  
BRIC is the Base Relevant Insurance Cost  
PIC is any Project Insurance Change

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<sup>36</sup> See Annex 5

<sup>37</sup> This definition may need to be tailored on a project specific basis, depending on the sector in which the project is let, eg schools projects should use the definition in the most recent version of the Schools standard form.

<sup>38</sup> The first insurance review takes place 12 months and one day following the Relevant Insurance Inception Date. The costs considered at the time of the first review will be:-

- the insurance premium payable to cover the first year of operation; and
- the insurance premium payable to cover the second year of operation.

With the exception of the last review, which, depending on Contract Period, may also occur after a shorter period, all other reviews will take place biennially.

<sup>39</sup> The Insurance Cost Decrease is always a positive sum (if not zero).

<sup>40</sup> In accordance with the definition of Project Insurance Change, the PIC may have either a positive or a negative value. In the event that the PIC is positive then the PIC is subtracted from the difference of the ARIC and the BRIC. If the PIC is negative, then the double negative means that the value of the PIC (ignoring the negative sign) is added to the difference of the ARIC and the BRIC.

**Insurance Cost Increase** means the Insurance Cost Differential if the value thereof is greater than zero<sup>41</sup>;

**Insurance Cost Index** means any index introduced by the United Kingdom Government or the Office of National Statistics after the date of this Contract and which is anticipated to be published annually to provide an independent and objective measure of changes in prevailing market insurance costs;

**Insurance Review Date** means the First Insurance Review Date and, thereafter, each date falling on the second anniversary of the previous Insurance Review Date, except where such date lies beyond the end of the Contract Period, in which case the Insurance Review Date shall be the last renewal date of the Relevant Insurance prior to the end of the Contract Period;

**Insurance Review Procedure** means the procedure set out in paragraph 2 of this Schedule [A];

**Insurance Review Period** means a two year period from the Relevant Insurance Inception Date and each subsequent two year period commencing on the second anniversary of the Relevant Insurance Inception Date except where the end of such period lies beyond the end of the Contract Period, in which case the Insurance Review Period shall be the period from the end of the penultimate Insurance Review Period to the last day of the Contract Period;

**Joint Insurance Cost Report** shall bear the meaning ascribed to it in paragraph 2.2 of this Schedule [A];

**PFI** means the United Kingdom's Private Finance Initiative;

**Portfolio Cost Saving** means any insurance cost saving which arises from the Contractor changing the placement of the Required Insurances from being on a stand-alone project-specific basis assumed at Financial Close and reflected in the Base Cost, to being on the basis of a policy (or policies) also covering risks on other projects or other matters which are outside the scope of the Project so as to benefit from portfolio savings. A Portfolio Cost Saving is defined to be a positive sum and cannot be less than zero<sup>42</sup>;

**Project Insurance Change** means any net increase or net decrease in the Actual Relevant Insurance Cost relative to the Base Relevant Insurance Cost, arising from:

- (a) the claims history or re-rating of the Contractor or any Contractor Related Party;
- (b) the effect of any change in deductible unless the following applies:-
  - i. such change is attributable to circumstances generally prevailing in the Relevant Insurance Market; and
  - ii. the deductible, further to such change, is either greater than or equal to the maximum<sup>43</sup> in Schedule [ ] (Required Insurance

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<sup>41</sup> The Insurance Cost Increase is always a positive sum (if not zero).

<sup>42</sup> An Authority may not be compelled to join a portfolio solution which places it in a worse position than if insurance is placed on a separate stand-alone basis.

<sup>43</sup> The Authority, in conjunction with its advisors, should set the maximum deductibles in the Required Insurance Schedule (see Annex 5) at the highest acceptable level.

Schedule)<sup>44</sup>;

- (c) any other issue or factor other than circumstances generally prevailing in the Relevant Insurance Market, except for any Portfolio Cost Saving<sup>45</sup>.

For the purpose of determining the Insurance Cost Differential, in the event that there is a net increase, the Project Insurance Change shall have a positive value. In the event that there is a net decrease the Project Insurance Change shall have a negative value.

**Relevant Insurance** means the Required Insurance and any other insurances as may be required by law other than:

- (a) Construction Period Insurance<sup>46</sup>;
- (b) Business Interruption Cover except to the extent that it relates to Unavoidable Fixed Costs<sup>47</sup>; and
- (c) [any ancillary insurances]<sup>48</sup>;

**Relevant Insurance Inception Date** means the date on which the Relevant Insurance is first providing active insurance cover to the Contractor, being a date no earlier than the Service Commencement Date;

**Relevant Insurance Market** means the insurance market which insures the majority of all PFI projects across all of the PFI sectors (as determined by the number of PFI projects). At the date of this Contract, the Relevant Insurance Market is in the [United Kingdom];

**Required Insurance** shall bear the meaning ascribed to it in the Contract<sup>49</sup>; and

**RPI** [shall bear the meaning ascribed to it in the Contract];

## 2 Insurance Review Procedure<sup>50</sup>

2.1 This procedure shall be used to determine whether the Authority shall bear any increase

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<sup>44</sup> The effect of this clause is to incentivise the Contractor to manage and optimise the trade-off between insurance premium and deductible levels for deductible levels below the maximum stipulated within the Authority Required Insurances, whilst providing protection in two specific circumstances: the first is where, due to circumstances generally prevailing in the Relevant Insurance Market, the cost of maintaining deductibles at the maximum stipulated in the Required Insurance Schedule has increased; and the second is where, due to circumstances generally prevailing in the Relevant Insurance Market, the Required Insurances can only be purchased with deductible levels above the maximum stipulated in the Schedule, wherein two principles apply: (a) the Contractor is given relief from breach by virtue of the provisions which deal with terms and conditions that become unavailable (see 24.10); and (b) the additional cost of purchasing insurances even at these increased deductible levels is eligible as an Insurance Cost Differential.

<sup>45</sup> This means that in addition to portfolio cost savings, changes which are attributable to a general movement in insurance costs across the *entire* PFI market will be taken into account.

<sup>46</sup> This is assumed to be covered under fixed-price arrangements and so not subject to variation.

<sup>47</sup> In addition to senior debt service costs, the Contractor may incur other unavoidable costs if the start of the operational period is delayed or in the event of an interruption to the operation of the project, e.g. any fixed cost for the provision of utilities. These unavoidable costs will vary from project to project. Unavoidable Fixed Costs is defined in Part 5 of Annex 5 and excludes Distributions.

<sup>48</sup> If the Required Insurance contains any supplementary (i.e. non-standard) insurances, for which Insurance Premium Risk Sharing is not being provided, these must also be referred to here.

<sup>49</sup> This will comprise the insurances in the required insurance schedule contained in the Contract, which should be based on the Standard Required Insurance Schedule (see Section 24.11 and Annex 5).

<sup>50</sup> The insurance review procedure takes place around each Insurance Review Date. The cost of insurance for the previous year and the cost of insurance for the current year are assessed at each review. With the exception of the first review, which takes place one day after the first insurance renewal, and possibly, depending on the Contract Period, the last review, all other reviews will take place biennially.

or benefit from any decrease in Relevant Insurance costs.

**2.2** The Contractor's insurance broker shall prepare a report on behalf of both the Contractor and the Authority (the **Joint Insurance Cost Report**). The Report is to be prepared at the Contractor's expense, and should, as a minimum, contain the following information for the relevant Insurance Review Period:

- 2.2.1** A full breakdown of the Actual Relevant Insurance Cost;
- 2.2.2** A full breakdown of the Base Relevant Insurance Cost;
- 2.2.3** A spreadsheet (the **Insurance Summary Sheet**) detailing separately:-
  - 2.2.3.1** the sum(s) insured / limit of indemnity (ie rateable factor) for each of the Relevant Insurances;
  - 2.2.3.2** the premium rate for each of the Relevant Insurances;
  - 2.2.3.3** the net premium paid (or to be paid) for each of the Relevant Insurances (ie excluding both insurance premium tax and brokers fees and commissions);
  - 2.2.3.4** the deductible(s) for each Relevant Insurance;
  - 2.2.3.5** details of any claims (paid or reserved) (including incident date, type and quantum) in excess of £[ ]<sup>51</sup>, being the amount stated in Clause [24.2(i)];
- 2.2.4** An assessment and quantification of each Project Insurance Change together with the reasons therefore;
- 2.2.5** Full details of any Portfolio Cost Saving;
- 2.2.6** Any other reasons that the Contractor believes may have caused a change (by way of increase or decrease relative to the Base Relevant Insurance Costs) in the Actual Relevant Insurance Cost;
- 2.2.7** The opinion of the Contractor's insurance broker as to the reasons why the Actual Relevant Insurance Cost has varied from the Base Relevant Insurance Cost, specifying the impact of each of the factors and quantifying the amount attributable to each factor specified above;
- 2.2.8** The calculation of the Insurance Cost Differential and any Exceptional Cost or Exceptional Saving arising from this calculation; and
- 2.2.9** Evidence satisfactory to the Authority (acting reasonably) of any changes to circumstances generally prevailing in the Relevant Insurance Market that are claimed to account for the Insurance Cost Differential
- 2.2.10** Details of movements in the CBS Private Capital non marine index<sup>52</sup>

<sup>51</sup> This amount should correspond to the amount agreed under Clause 24.2 (i) .

<sup>52</sup> CBS Private Capital (CBSPC) is a Lloyd's members' agent, specialising in the provision of advisory and administrative services to private and corporate capital providers underwriting in the Lloyd's insurance market. CBSPC uses syndicate analysts to undertake market research and, as part of its activities, maintains an index of insurance cost changes across the main asset classes. The CBSPC Market Rate Index

plus, if available from other appropriate sources, details of changes in insurance cost across the PFI market as a whole<sup>53</sup>.

- 2.3** The Contractor shall procure that the Broker, no later than the date which is ten (10) Business Days after the Insurance Review Date, delivers to the Authority, at the same time as it delivers to the Contractor, at least two copies of the Joint Insurance Cost Report. At the same time the Contractor should send a copy of the Insurance Summary Sheet to HM Treasury private finance unit or its nominee. Following receipt of the Joint Insurance Cost Report, the Authority shall notify the Contractor in writing within fifteen (15) Business Days whether or not it accepts the Joint Insurance Cost Report including full details of any disagreement<sup>54</sup>. If the Authority does not provide such notification and/or details of any disagreement to the Contractor within fifteen (15) Business Days, the Authority shall be deemed to have accepted the Joint Insurance Cost Report. If the Authority disagrees with any item in the Joint Insurance Cost Report, the Parties shall use their respective reasonable endeavors acting in good faith to agree the contents of the Joint Insurance Cost Report<sup>55</sup>. If the Parties fail to agree the contents of the Joint Insurance Cost Report within thirty five (35) Business Days from the date it was delivered to the Authority, the matter shall be resolved pursuant to Clause 27 (*Dispute Resolution*), provided always that references in Clause 27(d) to an expert shall be construed as references to an independent insurance expert agreed by the Parties or, in the absence of agreement, appointed by the President for the time being of the Chartered Institute of Arbitrators.
- 2.4** The Authority may make the Joint Insurance Cost Report available to any of its or HM Treasury's agents or advisers or other body or bodies nominated by HM Treasury for insurance cost verification, benchmarking or similar purpose.

### **3 Sharing of Exceptional Cost and Exceptional Saving**

- 3.1** If, following the completion of the Insurance Review Procedure, it is agreed or determined that there is an Exceptional Cost, the Authority shall within thirty (30) days of completion of the Insurance Review Procedure make a one-off lump-sum payment to the Contractor equal to 85% of the Exceptional Cost.
- 3.2** If, following the completion of the Insurance Review Procedure, it is agreed or determined that there is an Exceptional Saving, the Contractor shall within thirty (30) days of completion of the Insurance Review Procedure make a one-off lump-sum payment to the Authority equal to 85% of the Exceptional Saving.
- 3.3** Following the completion of the Insurance Review Procedure, if it is agreed or determined that there is neither an Exceptional Cost nor an Exceptional Saving, any Insurance Cost Differential shall be borne by or benefit the Contractor.

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was the first index of its kind, specifically focusing on the Lloyd's insurance market. It was started in 1994 and tracks the rate movements in the four main Lloyd's markets. The index was re-launched in 2005 when it was rebased to 1997, enabling investors to gauge where they are in the insurance cycle. The CBSPC non marine index may be accessed via the following web address: <http://www.cbs-loyds.co.uk/cgi-bin/mri/FileReader.pl>

<sup>53</sup> A source for such data could be Partnerships UK or any other body nominated by HM Treasury to act as custodian of the Insurance Summary Sheets.

<sup>54</sup> The Authority should consider employing the services of a fully 'independent' insurance advisor to confirm the accuracy of the information in the Joint Insurance Cost Report.

<sup>55</sup> This may involve observing how insurance costs have changed during the same period across a representative sample of PFI projects from *all* of the PFI sectors. Such information is likely to be available from a number of sources. The collation of Insurance summary Sheets centrally should facilitate this exercise.

#### 4 Insurance Cost Index

If at any time an Insurance Cost Index is published and intended for use in PFI contracts of a similar nature to this Contract, the Parties shall meet with a view to agreeing (a) its application to the Project, taking into account any relevant guidance issued by HM Treasury and (b) how a Portfolio Cost Saving may be accounted for when the index is in use.

#### **24.9 RISKS THAT BECOME UNINSURABLE**

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**24.9.1** The Contract must address the situation where a risk required to be insured against (i.e. a risk covered by a Required Insurance or statutory insurance) and which was previously insurable becomes uninsurable. In this context uninsurability includes both unavailability of insurance for a particular risk, or premiums being charged at a level which is not commercially viable. The approach adopted concentrates upon the availability of insurance cover for a particular risk rather than the availability of cover upon particular terms (with particular levels of deductibles) or conditions. Whilst uninsurability protection may be available if insurance for a particular risk to be covered by a Required Insurance is not available, there should be no uninsurability protection provided by the Authority to the Contractor for a term or condition (including deductibles at a specific level) becoming unavailable. In particular, uninsurability protection should not be offered in the event that non-vitiation protection is no longer available (see Section 24.2.2). The provisions for non availability of a Required Insurance term or condition are set out in Section 24.10.

**24.9.2** Whilst there is no uninsurability protection per se for changes in deductibles Contractors may, given the inverse correlation between premiums and deductibles, nonetheless benefit indirectly under the insurance premium risk sharing arrangement (see Section 24.8). If underwriters are inclined to increase deductibles to levels above the contractually agreed maxima (specified in the Required Insurance Schedule), then the premium payable will need to increase in order that underwriters provide insurance with deductibles at levels which do not exceed the agreed maxima. Under such circumstances (and if no off-setting reductions in the cost of other insurance cover and terms are available) the increased cost may become an Exceptional Cost (as determined under the Insurance Premium Risk Sharing Schedule (Schedule [A]) in Section 24.8) and so be subject to sharing with the Authority.

**24.9.3** The consequences of uninsurability (ranging from Contractor Default to the Authority accepting liability for occurrence of the event) will depend on the type of risk involved and whether either party was responsible for the uninsurability.

The required definition of “Uninsurable” for these purposes is as follows:

**“Uninsurable”**

means, in relation to a risk, either that:

- (a) insurance is not available to the Contractor in respect of the Project in the worldwide insurance market with reputable insurers of good standing in respect of that risk; or
- (b) the insurance premium payable for insuring that risk is at such a level that the risk<sup>56</sup> is not generally being insured against in the worldwide insurance<sup>57</sup> market<sup>58</sup> with reputable insurers of good standing by contractors in the United Kingdom.<sup>59</sup>

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<sup>56</sup> The effect of this provision should not be to give the Contractor protection against changes in terms of insurance or levels of deductibles, but to only give protection if the cost of insurance (on any terms) is at such a level that the market is not generally insuring against that risk.

<sup>57</sup> To the extent relevant, the wider risk transfer market (rather than just the insurance market) should be referred to. Insurance advice should be taken on this. Reference to any geographically narrower market, such as the European market, will not be acceptable.

<sup>58</sup> This approach is preferable to one dealing with the extent to which prices of premiums have increased.

<sup>59</sup> In projects where the Contractor retains end user risk, the Authority should consider whether it should give the Contractor any price

**24.9.4** A “risk” for these purposes is generally an insured peril which could be the proximate cause for a loss. The proximate cause is the initial act which sets off a natural and continuous sequence of events that produces physical loss or damage under a Material Damage policy, loss of revenue under a Delay in Start Up and Business Interruption policy, or injury and/or physical loss or damage to third parties and/or third party property under a Third Party Liability policy. For example, lightning causes a fire in school premises and this results in material damage to the school. In this example, the lightning is the proximate cause. Fire is not the proximate cause in the circumstances of this example (but could be a proximate cause for other claims).

**24.9.5** The Contractor should not be required to insure risks which become Uninsurable.

The following clause should be included to reflect this principle.

Nothing in this clause shall oblige the Contractor to take out insurance in respect of a risk which is Uninsurable save where the predominant cause of the risk being Uninsurable is any act(s) or omission(s) of the Contractor or a Contractor Related Party.

If, however, a risk which is to be insured against under the Required Insurances or statutory insurances, becomes Uninsurable, the Contractor will be in breach of Contract where it has caused the relevant risk to be Uninsurable, which will give rise to a termination right for Contractor Default (see Section 20.2.2 (Events Leading to Termination)).

**24.9.6** Unavailability of insurance should not be at the sole risk of the Authority. If a particular risk usually covered by the insurances referred to in Clauses 24.2(a) and 24.2(b)<sup>60 61</sup> becomes uninsurable to the extent that the Contractor and other contractors operating in similar sectors shut down their operations as the means of managing the particular risk, then neither party should be entitled to terminate the Contract. If (in respect of the risk concerned) insurance becomes unavailable for reasons outside the control of the Contractor, then the parties should consider alternative approaches to the risk to consider if they can agree a means by which it can be managed or shared. If, however, no agreement is reached and the risk reverts to the Authority then (subject to Section 24.9.7 below) the amount of the premium previously paid is deducted from the Unitary Charge. If the risk then occurs, the Authority can choose either to pay an amount equal to the insurance proceeds that would have been payable had the Required Insurances or statutory insurances been available (in which case termination will not occur) or terminate the Contract and pay compensation equivalent to the amount payable on a Force Majeure termination to the Contractor (see Section 20.3).

**24.9.7** In the event that a risk is uninsurable and the Contract continues, the Contractor shall be obliged to approach the insurance market at regular intervals to determine whether the risk has become insurable again.

**24.9.8** The Contractor should not be obliged to continue to provide services under the Contract where third-party liability cover has ceased to become insurable and the Authority and the Contractor are unable to agree how to manage that risk. If third-party liability insurance becomes unavailable for reasons that are outside of the control of the Contractor and the parties are unable to agree the means by which the risk should be managed by the Contractor, the Authority should be able to elect to either self-insure the risk or terminate the Contract and pay compensation to the Contractor equivalent to the amount payable on a Force Majeure termination (see Section

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protection in relation to increases in insurance premiums (i.e. paragraph (b) of the definition of Uninsurable can be deleted) as the Contractor can manage such increases by increasing the price that the end user pays for the Services to reflect any increase in insurance premiums for the Project.

<sup>60</sup> See Sections 24.2.1 and 24.2.2 for discussion.

<sup>61</sup> These are the Required Insurances (e.g. [contractors' 'all risks' insurance, property damage insurance, delay in start up and business interruption insurance (but not loss of profits - see Section 24.2.3), third party liability insurance]) and statutory insurances (e.g. employer's liability insurance).

20.3). If it is agreed that the Contract should continue then the amount of the premium previously paid should be deducted from the Unitary Charge.

**24.9.9** It is unacceptable for indemnity provisions in the Contract to be used to subvert the apportioned risk transfer position on uninsurability of risk and unavailability of deductibles in this Section 24.9.

The following is the required drafting:

#### **24.9 Uninsurable Risks**

- (a) If a risk usually covered by [contractors' 'all risks' insurance, property damage insurance, third party liability insurance, delay in start up and business interruption insurance (but not loss of profits<sup>62</sup>) or statutory insurances]<sup>63</sup> in each case required under this Contract becomes Uninsurable then:
    - (i) the Contractor shall notify the Authority within [5] days of the risk becoming Uninsurable<sup>64</sup>; and
    - (ii) if both parties agree, or it is determined in accordance with Clause 27 (Dispute Resolution) that the risk is Uninsurable and that:
      - (A) the risk being Uninsurable is not caused by the actions of the Contractor or any sub-contractor of the Contractor (of any tier); and
      - (B) the Contractor has demonstrated to the Authority that the Contractor and a prudent board of directors of a company operating the same or substantially similar PFI businesses in the United Kingdom to that operated by the Contractor would in similar circumstances (in the absence of the type of relief envisaged by this clause) be acting reasonably and in the best interests of the company if they resolved to cease to operate such businesses as a result of that risk becoming Uninsurable, taking into account inter alia (and without limitation) the likelihood of the Uninsurable risk occurring (if it has not already occurred), the financial consequences for such company if such Uninsurable risk did occur (or has occurred) and other mitigants against such consequences which may be available to such company
- the parties shall meet to discuss the means by which the risk should be managed or shared (including considering the issue of self-insurance by either party)<sup>65</sup>.
- (b) If the requirements of paragraph (a) are satisfied, but the parties cannot agree as to how to manage or share the risk, then:
    - (i) in respect of such third party liability insurance only the Authority shall (at the Authority's option) either pay to the Contractor an amount equal to the amount calculated in accordance with Clause 20.3.2 (Compensation on Termination for Force Majeure) and the Contract will terminate, or elect to

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<sup>62</sup> See Section 24.2.3.

<sup>63</sup> That is, the insurances referred to in Clause 24.2(a) and Clause 24.2(b). See Sections 24.2.1 and 24.2.2 for discussion.

<sup>64</sup> The Authority may elect to use the following alternative wording: 'the Contractor shall notify the Authority of any risk becoming Uninsurable within 5 Business Days of becoming aware of the same and in any event at least 5 Business Days before expiry or cancellation of any existing insurance in respect of that risk'.

<sup>65</sup> In the event that a risk becomes Uninsurable and the parties are required to meet to discuss how to manage the risk, the Authority should take into consideration the extent to which it may be deemed to be carrying out insurance business in the event that the parties are unable to agree and the provisions of Clause 24.9(b) apply. In the event that the Authority believes that it would be conducting insurance business, it should consider whether it has the necessary powers and authorisations to do so.

- allow the Contract to continue and paragraph (ii) below shall thereafter apply in respect of such risk; and
- (ii) in respect of such [contractors' 'all risks' insurance, property damage insurance, third party liability insurance (if the Authority elects to allow the Contract to continue in accordance with Clause 24.9(b)(i)), delay in start up and business interruption insurance (but not loss of profits) or statutory insurances] the Contract shall continue and on the occurrence of the risk (but only for as long as such risk remains Uninsurable) the Authority shall (at the Authority's option) either pay to the Contractor an amount equal to insurance proceeds that would have been payable had the relevant insurance continued to be available and the Contract will continue, or an amount equal to the amount calculated in accordance with Clause 20.3.2 (Compensation on Termination for Force Majeure) plus (in relation to third party liability insurance only) the amount of insurance proceeds that would have been payable whereupon the Contract will terminate; and
  - (iii) where pursuant to paragraphs (b)(i) and/or (ii) this Contract continues then the Unitary Charge shall be reduced in each year for which the relevant insurance is not maintained by an amount equal to the premium paid (or which would have been paid) by the Contractor in respect of the relevant risk in the year prior to it becoming Uninsurable (Indexed from the date that the risk becomes Uninsurable). Where the risk is Uninsurable for part of a year only the reduction in the Unitary Charge shall be pro rated to the number of months for which the risk is Uninsurable; and
  - (iv) where pursuant to paragraphs (b)(i) and/or (ii) this Contract continues the Contractor shall approach the insurance market at least every four months to establish whether the risk remains Uninsurable. As soon as the Contractor is aware that the risk is no longer Uninsurable, the Contractor shall take out and maintain or procure the taking out and maintenance of insurance (to be incepted as soon as is reasonably practicable) for such risk in accordance with this Contract<sup>66</sup>.
- (c) If, pursuant to Clause 24.9(b)(ii), the Authority elects to make payment to the Contractor (such that the Contract will terminate)(the "Relevant Payment"), the Contractor shall have the option (exercisable in writing within (20) Business Days of the date of such election by the Authority (the "Option Period")) to pay to the Authority on or before the end of the Option Period, an amount equal to the insurance proceeds that would have been payable had the relevant risk not become Uninsurable, in which case the Contract will continue (and the Relevant Payment will not be made by the Authority), and the Contractor's payment shall be applied for the same purpose and in the same manner as insurance proceeds would have been applied had the relevant risk not become Uninsurable.

## **24.10 TERMS AND CONDITIONS THAT BECOME UNAVAILABLE**

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<sup>66</sup> Additional sub-clauses (v) and (vi) may be added at the Authority's discretion as follows :

(v) In respect of any period between the Authority receiving notification in accordance with Clause 24.9(a)(i) that a TPL Risk has become Uninsurable and the Authority's notification to the Contractor in accordance with Clause 24.9(b)(i) in respect of such risk then, provided it is ultimately agreed or determined that the requirements of Clause 24.9(a)(ii) are satisfied in respect of the Uninsurable TPL Risk and subject to Clause 24.9(b)(vi) below, Clause 24.9(b)(ii) shall apply in respect of occurrences of the Uninsurable TPL Risk during such period unless the parties otherwise agree how to manage the risk during this period; and

(vi) Clause 24.9(b)(v) shall only apply provided the Contractor does not unreasonably materially delay (a) agreement and/or determination in accordance with the Dispute Resolution Procedure as to whether the requirements of Clause 24.9(a)(ii) are satisfied in respect of the Uninsurable TPL Risk and/or (b) meeting with the Authority to discuss the means by which the risk should be managed.

TPL Risk should be defined as 'a risk which is required to be insured under the third party liability insurance policy'.

**24.10.1** If insurance for a term or condition (as opposed to a risk (see Section 24.9)) is no longer available, subject to the unavailability of such term or condition not being attributable to the actions of the Contractor or a Sub-contractor, the Contractor should not be obliged to take out insurance in respect of that particular term or condition. Accordingly the Authority should not terminate for a Contractor Default (see Section 20.2) in this situation. Such unavailability will instead be treated like a Relief Event. Uninsurability protection under Clause 24.9 should not be offered by the Authority where any particular term or condition in the Required Insurance Schedule (including deductibles at levels above the maximum level stated in the required insurance schedule) is unavailable.

**24.10.2** If insurance is no longer available for a term or condition included in the Contract as a Required Insurance, the parties may agree that the Unitary Charge should be reduced to reflect the extent to which the insurance premium payable by the Contractor is lower than it would have been had insurance been effected for the particular term or condition. Whilst the increased risk further to unavailability of a term or condition may reside first and foremost with the Contractor, the Authority's exposure is likely to be increased, as there may be certain circumstances where the Authority bears the risk eg where an aggrieved party brings a claim against the Authority for an act committed by the Contractor, but insurance proceeds to cover the claim are no longer available on account of the unavailability of a term or condition. The extent to which the Authority may be exposed will depend in part on the indemnity provisions. In addition where there is such a loss, then if the Contractor elects not to reinstate the loss, then depending on the size of the loss, it is possible that the Authority would not be able to terminate for Contractor Default, and be forced to accept instead a reduced service. Given that an Authority's potential exposure will depend on contractual provisions, some of which may be project specific, an adjustment to the Unitary Charge further to unavailability of a term or condition is not mandatory. It is for the Authority to determine, in conjunction with the insurance and legal advisors whether the Contract should contain a unitary charge adjustment provision. If it is determined that this provision is appropriate then suggested language is included in 24.10(d) and (e) below.

**24.10.3** If a term or condition is not available, the Contractor should determine whether an alternative term or condition could, either wholly or partially, replace the term or condition which is unavailable. If appropriate and available on a commercially viable basis, the alternative term or condition should be procured.

Required drafting is as follows:

**"Insurance Term"** means any terms and/or conditions required to be included in a policy of insurance by Clause 24.2 and/or Schedule [] (Required Insurance Schedule) but excluding any risk.

#### **24.10**

- (a) If, upon the renewal of any insurance which the Contractor is required to maintain or to procure the maintenance of pursuant to this Contract:
- (i) any Insurance Term is not available to the Contractor in the worldwide insurance market with reputable insurers of good standing; and/or
  - (ii) the insurance premium payable for insurance incorporating such Insurance Term is such that the Insurance Term is not generally being incorporated in insurance procured in the worldwide insurance market with reputable insurers of good standing by contractors in the United Kingdom,
- (other than, in each case, by reason of one or more actions of the Contractor and/or any sub-contractor of the Contractor (of any tier)) then paragraph (b) shall apply.

- (b) If it is agreed or determined that paragraph (a) applies then the Authority shall waive the Contractor's obligations in Clause 24.2 and/or Schedule [] (Required Insurance Schedule) in respect of that particular Insurance Term and the Contractor shall not be considered in breach of its obligations regarding the maintenance of insurance pursuant to this Contract as a result of the failure to maintain insurance incorporating such Insurance Term for so long as the relevant circumstances described in paragraph (a) continue to apply to such Insurance Term.
- (c) To the extent that the Parties agree (acting reasonably), or it is determined pursuant to the Dispute Resolution Procedure, that an alternative or replacement term and /or condition of insurance is available to the Contractor in the worldwide insurance market with reputable insurers of good standing which if included in the relevant insurance policy would fully or partially address the Contractor's inability to maintain or procure the maintenance of insurance with the relevant Insurance Term, at a cost which contractors in the UK are (at such time) generally prepared to pay, the Contractor shall maintain or procure the maintenance of insurance including such alternative or replacement term and/or condition. Notwithstanding any other provision of this Contract, the costs of such insurance shall be subject to the premium costs sharing mechanism set out at Schedule [A] [Insurance Premium Risk Sharing Schedule].
- (d) [Where the Authority has exercised the waiver pursuant to paragraph (b), it shall be entitled to deduct from the annual Unitary Charge the "Adjusted Amount", such amount being an amount equal to the amount paid for the particular Insurance Term in the preceding year (using a reasonable estimate of such amount where a precise figure is not available) less any annual amount paid or payable by the Contractor to maintain and/or procure the maintenance of any (whether full or partial) alternative or replacement insurance in respect of such Insurance Term pursuant to paragraph (c).]<sup>67</sup>
- (e) [While paragraph (a) applies, the annual Unitary Charge shall be reduced each Contract Year by the Adjusted Amount, Indexed from the date that the particular Insurance Term is no longer available.]<sup>68</sup>
- (f) The Contractor shall notify the Authority as soon as reasonably practicable and in any event within five days of becoming aware that paragraph (a)(i) and/or paragraph (a)(ii) are likely to apply or (on expiry of the relevant insurance then in place) do apply in respect of an Insurance Term (irrespective of the reason for the same). The Contractor shall provide the Authority with such information as the Authority reasonably requests regarding the unavailability of the Insurance Term and the parties shall meet to discuss the means by which such unavailability should be managed as soon as is reasonably practicable.
- (g) In the event that paragraph (a)(i) and/or paragraph (a)(ii) apply in respect of an Insurance Term, (irrespective of the reasons for the same) the Contractor shall approach the insurance market at least every four months to establish whether paragraph (a)(i) and/or paragraph (a)(ii) remain applicable to the Insurance Term. As soon as the Contractor is aware that paragraph (a)(i) and/or paragraph (a)(ii) has ceased to apply to the Insurance Term, the Contractor shall take out and maintain or procure the taking out and maintenance of insurance (to be incepted

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<sup>67</sup> See Section 24.10.2

<sup>68</sup> See Section 24.10.2

as soon as is reasonably practicable) incorporating such Insurance Term in accordance with this Contract.

## **24.11 STANDARD REQUIRED INSURANCE SCHEDULE**

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**24.11.1** This Contract schedule sets out the Authority's Required Insurances requirements. The Standard Required Insurance Schedule ("SRIS") as set out below broadly reflects the insurance provisions included in the insurance schedule for the majority of PFI projects.

**24.11.2** Variations from the SRIS should be kept to a minimum and Authorities should be aware that the broader the scope of the insurances, the greater the possibility that uninsurability protection will apply. However since this is a generic document, a limited level of adjustment may be appropriate during pre financial close negotiations. This should be determined by the Authority in conjunction with its insurance adviser, to ensure that the provisions in the insurance schedule are tailored to the requirements of each Project. Project-specific modifications could, for example, include:-

- Insertion of an appropriate limit of indemnity for the third party liability policies;
- A change to the period of insurance in the event that service commencement is phased, or construction extends beyond service availability date, e.g. a multi-site facility;
- Addition or deletion of project specific extensions and relevant footnotes;
- Inclusion of additional insurance cover where appropriate;
- Insertion of a figure for each maximum deductible;
- Change to the jurisdiction and/or territorial limits under the third party liability policy.

**24.11.3** In addition to the project-specific amendments, the drafting may to some extent need to be amended to reflect the availability of insurance generally, including the main terms and conditions in the prevailing insurance market. In particular, the detailed endorsement wordings in Part 3 may need to be amended should market circumstances change.

**24.11.4** For the reason given in Section 24.2.2, professional indemnity insurance should not be included as a Required Insurance. Additional reasons for excluding this insurance from the Required Insurances include the following:-

- it will not be possible for the Authority to be named as an additional insured and thus benefit directly from the insurance policy;
- when placed on a project specific basis this tends to be very expensive and provide only limited additional comfort to the insured party;

**24.11.5** Maximum deductibles should primarily be set at a level which reflects the maximum level of exposure which an Authority is reasonably able to bear for any of its own losses and which the Contractor could bear for its own losses. The main determinant should not be the lowest deductible limit available in the prevailing market. For many projects it is anticipated that the maximum deductible could be higher than that which is available in the prevailing market.

**24.11.6** Clause 24.9.1 states that uninsurability protection is intended to apply to risks only (rather than the availability of cover upon particular terms or conditions). The risks which benefit from uninsurability protection are those which are covered by the Required Insurances and any other risks covered by statutory insurance. If a risk is Uninsurable and the uninsurability test in Clause 24.9 is satisfied, the Authority may, on the occurrence of a loss (or, in respect of third party

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liability at the time that the risk becomes Uninsurable) terminate the Contract and pay compensation to the Contractor equivalent to an amount payable on a Force Majeure termination in accordance with Clause 24.9(b)(i)&(ii). This payment will therefore not represent "full" compensation as equity repayment will be limited to par value less Distributions paid to date. This provision serves to control the extent to which uninsurability protection is relied upon.

Suitable drafting is set out in Annex 5.

## Annex 5

### **Standard Required Insurance Schedule (Schedule [] Required Insurances)**

This is Schedule [] comprising the Required Insurances referred to in the Contract for [ ] between:

[Authority/Trust]  
-And-  
[Contractor]

This Schedule [] comprises five Parts-

**PART 1:** Policies to be taken out by the Contractor and maintained during the [design and construction phase]

**PART 2:** Policies to be taken out by the Contractor and maintained during the Service Period

**PART 3:** Endorsements

**PART 4:** Broker's Letter of Undertaking

**PART 5:** Definitions

## Part 1

### **Policies to be taken out by the Contractor and maintained during the [design and construction phase].**

Common to each policy in Part 1 (unless stated otherwise):

#### **Insureds:-**

1. Authority/Trust.
2. Contractor.
3. Construction Sub-contractor.
4. [Operating Sub-contractor].
5. Construction sub-contractors of any tier.
6. Senior Lenders.
7. Subordinated Lenders.
8. Consultants - for their site activities only.

each for their respective rights and interests in the Project.

### **1. Contractors' 'All Risks' Insurance (CAR)**

#### **1.1 Insured Property**

The permanent and temporary works, materials [(including but not limited to equipment supplied by the Authority/Trust)]<sup>69</sup>, goods, plant and equipment for incorporation in the works (other than constructional plant, tools, accommodation and equipment belonging to or the responsibility of the Construction Sub-contractor or the Construction Sub-contractor's sub-Contractors) and all other property used or for use in connection with works associated with the Project.

#### **1.2 Coverage**

"All risks" of physical loss or damage to the Insured Property unless otherwise excluded.

#### **1.3 Sum Insured**

At all times an amount not less than the full reinstatement or replacement value of the Insured Property, but not less than the value specified in the building contract plus provision to include extensions as appropriate<sup>70</sup>.

#### **1.4 Maximum Deductible**

£ [ ]

#### **1.5 Territorial Limits**

United Kingdom including offsite storage and during inland transit.

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<sup>69</sup> Include as appropriate as this is project specific.

<sup>70</sup> For certain projects where a total loss is inconceivable (e.g. road and rail) the sum insured could correspond to the Estimated Maximum Loss (ABI definition), rather than the full reinstatement value.

## **1.6 Period of Insurance**

From the date of the Contract until the Service Commencement Date and thereafter in respect of defects liability until expiry of the [12] months defects liability period.

## **1.7 Cover Features & Extensions**<sup>71</sup>

1. Terrorism.<sup>72 73</sup>
2. Munitions of war clause.
3. Additional costs of completion clause.
4. Professional fees clause.
5. Debris removal clause.
6. 72 hour clause.
7. European Union local authorities clause.
8. Free issue materials clause.
9. [10]% escalation clause.
10. Automatic reinstatement of sum insured clause.
11. Loss minimisation.

## **1.8 Principal Exclusions**

1. War and related perils (UK market agreed wording).
2. Nuclear/radioactive risks (UK market agreed wording).
3. Pressure waves caused by aircraft and other aerial devices traveling at sonic or supersonic speeds.
4. Wear, tear and gradual deterioration.
5. Consequential financial losses.
6. Cyber risks.
7. Inventory losses, fraud and employee dishonesty.

## **2 Delay in Start Up Insurance (DSU)**

### **2.1 Insureds**

1. Contractor.
2. Senior Lenders.
3. Subordinated Lenders.
4. Authority/Trust<sup>74</sup>.

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<sup>71</sup> Additional Cover Features & Extensions may be appropriate for certain projects.

<sup>72</sup> For certain projects where there is only a very remote likelihood of the risk materialising, and the probable impact of any such loss is perceived as being very low, e.g. street lighting projects, an Authority may elect not to include this extension as a Required Insurance.

<sup>73</sup> For projects in England, Scotland and Wales the majority of this cover is *typically* provided by the Government-backed market mutual reinsurer: 'Pool RE'. Pool RE does not provide protection for projects in Northern Ireland. However under the provisions of the Criminal Damage (Compensation) Northern Ireland Order 1977, these projects will instead benefit from compensation provided by the Northern Ireland Office (see SoPCNI section 24.3). (Note: This does not preclude use of commercial insurance should it become available).

<sup>74</sup> The Authority/Trust should be named as a co-insured party to the extent that it has a demonstrable insurable interest. This will be in connection with any additional cost of working insured against under the terms of the policy, and not with respect to any loss of

each for their respective rights and interests in the Project.

## **2.2 Indemnity**

In respect of:

1. loss of anticipated Revenue during at least the Minimum Indemnity Period arising from a delay in completion of the Project as a result of loss or damage covered under the Contractors' All Risks' Insurance effected in accordance with Item 1 of Part 1 of this Schedule, including physical loss or damage which would be indemnifiable but for the application of any deductible;

2. the economic additional expenditure necessarily and reasonably incurred for the purpose of avoiding or reducing the loss of Revenue of the Contractor which without such expenditure would have taken place, during the Minimum Indemnity Period.

## **2.3 Sum Insured**

An amount sufficient to cover the sums the subject of the Indemnity for the Minimum Indemnity Period.<sup>75</sup>

## **2.4 Maximum Excess**

[ ] days.

## **2.4 Minimum Indemnity Period**

[12] months.

## **2.6 Period of Insurance**

As per the Contractors' "All Risks" Insurance, excluding the defects liability period.

## **2.7 Cover Features & Extensions<sup>76</sup>**

1. Denial of access.
2. Utilities.
3. Terrorism.<sup>77 78</sup>
4. Automatic Reinstatement of sum insured.
5. Professional Fees.

## **2.8 Principal Exclusions**

1. The exclusions under the Contractors' 'All Risks' Insurance, other than for consequential financial losses.
2. Delayed response by a public body or state authority.

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anticipated Revenue.

<sup>75</sup> For certain projects where a total interruption to the operation of the project is inconceivable (e.g. multiple sites), a sum insured which is lower than the theoretical maximum loss of Revenue may be appropriate.

<sup>76</sup> For certain projects additional Cover Features & Extensions may be appropriate e.g. suppliers extension for the premises of specified suppliers.

<sup>77</sup> For certain projects where there is only a very remote likelihood of the risk materialising, and the probable impact of any such loss is perceived as being very low, e.g. street lighting projects, an Authority may elect not to include this extension as a Required Insurance.

<sup>78</sup> For projects in England, Scotland and Wales the majority of this cover is typically provided by the Government-backed market mutual reinsurer: 'Pool RE'. Pool RE does not provide protection for projects in Northern Ireland. However under the provisions of the Criminal Damage (Compensation) Northern Ireland Order 1977, these projects will instead benefit from compensation provided by the Northern Ireland Office (see SoPCNI section 24.3). (Note: This does not preclude use of commercial insurance should it become available).

### **3. Construction Third Party Liability Insurance<sup>79</sup>**

#### **3.1 Interest**

To indemnify the Insured in respect of all sums that they may become legally liable<sup>80</sup> to pay (including claimant's costs and expenses) as damages in respect of accidental:

- (a) death, or bodily injury, illness, death, disease contracted by any person;
- (b) loss or damage to property;
- (c) interference to property or any easement right of air, light, water or way or the enjoyment or use thereof by obstruction, trespass, nuisance, loss of amenities, or any like cause.

happening during the Period of Insurance and arising out of or in connection with the Project.

#### **3.2 Limit of Indemnity**

Not less than £[ ]m<sup>81</sup> in respect of any one occurrence, the number of occurrences being unlimited, but in the aggregate in respect of pollution liability.

#### **3.3 Maximum Deductible £[ ] for each and every occurrence of property damage. (Personal injury claims will be paid in full<sup>82</sup>).**

#### **3.4 Territorial Limits**

UK [and elsewhere in the world in respect of non manual visits].

#### **3.5 Jurisdiction**

UK [and elsewhere in the world in respect of non manual visits].

#### **3.6 Period of Insurance**

As per the Contractors' "All Risks" Insurance, including the defects liability period.

#### **3.7 Cover Features & Extensions<sup>83</sup>**

1. Munitions of war.
2. Cross liability clause.
3. Contingent motor.
4. Legal defense costs.

#### **3.8 Principal Exclusions**

1. Liability for death, illness, disease or bodily injury sustained by employees of the insured.

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<sup>79</sup> If possible, insurance should be placed on a losses occurring basis.

<sup>80</sup> Cover should be for contractual liability, statutory liability and liability in tort.

<sup>81</sup> Limit should be determined by the Authority, in conjunction with its insurance adviser, taking into account the relevant circumstances of the project.

<sup>82</sup> For certain projects an excess may apply to personal injury claims.

<sup>83</sup> For certain projects, additional Cover Features & Extensions may need to be noted e.g. terrorism, legionella (for schools and hospitals) and liabilities arising from maintenance of site helipad (for hospitals).

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2. Liability arising out of the use of mechanically propelled vehicles whilst required to be compulsorily insured by legislation in respect of such vehicles.
3. Liability in respect of predetermined penalties or liquidated damages imposed under any contract entered into by the Insured.
4. Liability in respect of loss or damage to property in the care, custody and control of the insured but this exclusion is not to apply to all property belonging to the Authority/Trust which is in the care, custody and control of another Insured.
5. Events more properly covered under a professional indemnity policy.
6. Liability arising from the ownership, possession or use of any aircraft or marine vessel.
7. Liability arising from seepage and pollution unless caused by a sudden, unintended and unexpected occurrence.
8. Losses indemnified under the CAR policy or DSU policy.

## Part 2

### **Policies to be taken out by the Contractor and maintained during the Service Period.**

Common to all policies in Part 2 (unless stated otherwise):

#### **Insureds:-**

1. Authority/Trust.
2. Contractor.
3. Operating Subcontractor.
4. Operating Sub-subcontractors.<sup>84</sup>
5. Senior Lenders.
6. Subordinated Lenders.

each for their respective rights and interests in the Project.

### **1. Property Damage Insurance**

#### **1.1 Insured Property**

The project assets which are the property of the Contractor or for which the Contractor may be responsible including but not limited to the new facilities.

#### **1.2 Coverage**

“All risks” of physical loss or damage to the Insured Property from any cause not excluded, including machinery breakdown and computer breakdown in respect of appropriate equipment<sup>85</sup>.

#### **1.3 Sum Insured**

At all times an amount not less than the total reinstatement or replacement value of the Insured Property<sup>86</sup> plus provision to include other Principal Extensions as appropriate. (escalated periodically as appropriate)<sup>87</sup>

#### **1.4 Maximum Deductible**

£[ ] each and every claim. (escalated periodically as appropriate)

#### **1.5 Territorial Limits**

United Kingdom plus elsewhere whilst in inland transit.

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<sup>84</sup> To the extent that their activities are required to be insured under contract.

<sup>85</sup> For projects with large and expensive equipment/machinery (e.g. large hospital projects) a separate engineering policy may be required.

<sup>86</sup> For certain projects, where a total loss is inconceivable (e.g. road and rail) the sum insured could correspond to the Estimated Maximum Loss, rather than the full reinstatement value.

<sup>87</sup> It will be important for the parties to agree an appropriate method of escalation.

**1.6 Period of Insurance**

From the Service Commencement Date or as otherwise specified in the Contract for the duration of the Contract and renewable on an annual basis unless agreed otherwise by the Parties.

**1.7 Cover Features & Extensions<sup>88</sup>**

1. Terrorism<sup>89 90</sup>
2. Automatic reinstatement of sum insured.
3. Capital additions clause.
4. 72 hour clause.
5. European Union local authorities clause.
6. Professional fees.
7. Debris removal.
8. Pollution and contamination to the Insured Property arising from an event which itself is not otherwise excluded.
9. Repair / reinstatement basis of claims settlement with cash option for non-reinstatement.

**1.8 Principal Exclusions**

1. War and related perils (UK market agreed wording).
2. Nuclear/radioactive risks (UK market agreed wording).
3. Pressure waves caused by aircraft and other aerial devices traveling at sonic or supersonic speeds.
4. Wear, tear and gradual deterioration.
5. Consequential financial losses.
6. Cyber risks.
7. Losses recovered under the CAR policy.

**2. Business Interruption Insurance<sup>91</sup>**

**2.1 Insureds**

1. Contractor.
2. Senior Lenders.
3. Subordinated Lenders.
4. Authority/Trust.<sup>92</sup>

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<sup>88</sup> For certain hospital projects additional Cover Features & Extensions should be noted, including cover for clean up costs necessarily incurred by the Insured as a result of the outbreak of any infectious or contagious disease, including but not limited to MRSA and Legionella.

<sup>89</sup> For certain projects where there is only a very remote likelihood of the risk materialising, and the probable impact of any such loss is perceived as being very low, e.g. street lighting projects, an Authority may elect not to include this extension as a Required Insurance.

<sup>90</sup> For projects in England, Scotland and Wales the majority of this cover is typically provided by the Government-backed market mutual reinsurer: 'Pool RE'. Pool RE does not provide protection for projects in Northern Ireland. However under the provisions of the Criminal Damage (Compensation) Northern Ireland Order 1977, these projects will instead benefit from compensation provided by the Northern Ireland Office (see SoPCNI section 24.3). (Note: This does not preclude use of commercial insurance should it become available).

<sup>91</sup> Not typically required for street-lighting projects.

each for their respective rights and interests in the Project.

## **2.2 Indemnity**

In respect of:

1. loss of anticipated Revenue during at least the Minimum Indemnity Period arising from an interruption or interference in the operation of the Project as a result of loss or damage covered under Property Damage Insurance effected in accordance with paragraph 1 of Part 2 of this Schedule including physical loss or damage which would be indemnifiable but for the application of any deductible;
2. the economic additional expenditure necessarily and reasonably incurred for the purpose of avoiding or reducing the loss of Revenue of the Contractor which without such expenditure would have taken place, during the Indemnity Period.

## **2.3 Sum Insured**

An amount sufficient to cover the sums the subject of the Indemnity for the Minimum Indemnity Period.

## **2.4 Maximum Excess**

[ ] days.

## **2.5 Minimum Indemnity Period**

[12] months.

## **2.6 Period of Insurance**

From the Service Commencement Date for the duration of the Contract and renewable on an annual basis unless agreed otherwise.

## **2.7 Cover Features & Extensions<sup>93</sup>**

1. Denial of access.
2. Terrorism.<sup>94 95</sup>
3. Utilities.
4. Accountants Clause.
5. Automatic reinstatement of sum insured.

## **2.8 Principal Exclusions**

1. Exclusions under the Property Damage Insurance, other than for consequential financial losses.
2. Delayed response by a public body or state authority.

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<sup>92</sup> The Authority/Trust should be named as a co-insured party to the extent that it has a demonstrable insurable interest. This will be in connection with any additional cost of working insured against under the terms of the policy, and not with respect to any loss of anticipated Revenue.

<sup>93</sup> For certain projects additional Cover Features & Extensions may be required: infectious disease, specified suppliers.

<sup>94</sup> For projects in England, Scotland and Wales the majority of this cover is typically provided by the Government-backed market mutual reinsurer: 'Pool RE'. Pool RE does not provide protection for projects in Northern Ireland. However under the provisions of the Criminal Damage (Compensation) Northern Ireland Order 1977, these projects will instead benefit from compensation provided by the Northern Ireland Office (see SoPCNI section 24.3). (Note: This does not preclude use of commercial insurance should it become available).

<sup>95</sup> For certain projects where there is only a very remote likelihood of the risk materialising, and the probable impact of any such loss is perceived as being very low, e.g. street lighting projects, an Authority may elect not to include this extension as a Required Insurance.

### **3. Third Party Public and Products Liability Insurance<sup>96</sup>**

#### **3.1 Interest**

To indemnify the Insured in respect of all sums that they may become legally liable<sup>97</sup> to pay (including claimant's costs and expenses) as damages in respect of accidental:

1. death, or bodily injury, illness, death, disease contracted by any person;
2. loss or damage to property;
3. interference to property or any easement right of air, light, water or way or the enjoyment or use thereof by obstruction, trespass, nuisance, loss of amenities, or any like cause.

happening during the period of insurance and arising out of or in connection with the Project and the provision of the Services.

#### **3.2 Limit of Indemnity**

Not less than £[ ]m<sup>98</sup> (*escalated periodically as appropriate*)<sup>99</sup> in respect of any one occurrence, the number of occurrences being unlimited, but in the aggregate in respect of pollution and products liability.

#### **3.3 Maximum Deductible**

£[ ] for each and every occurrence of property damage (escalated periodically as appropriate). (Personal injury claims will be paid in full<sup>100</sup>).

#### **3.4 Territorial Limits**

UK [and elsewhere in the world in respect of non manual visits].

#### **3.5 Jurisdiction**

UK [and elsewhere in the world in respect of non manual visits].

#### **3.6 Period of Insurance**

From Service Commencement Date or as otherwise specified in the Contract for the duration of the Contract and renewable on an annual basis unless agreed otherwise.

#### **3.7 Cover Features & Extensions<sup>101</sup>**

1. Munitions of war.
2. Cross liability clause.
3. Contingent motor.

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<sup>96</sup> Insurance should be maintained on a losses occurring basis.

<sup>97</sup> Cover should be for contractual liability, statutory liability and liability in tort.

<sup>98</sup> Limit should be determined by the Authority in conjunction with its insurance adviser, taking into account the relevant circumstances of the project.

<sup>99</sup> It will be important for the parties to agree an appropriate method of escalation.

<sup>100</sup> For certain projects an excess may apply to personal injury claims.

<sup>101</sup> For certain projects, additional Cover Features & Extensions may be required e.g. legionella (for schools and hospitals), liabilities arising from maintenance of site helipad (for hospitals) and terrorism.

4. legal defense costs.

**3.8 Principal Exclusions**

1. Liability for death, illness, disease or bodily injury sustained by employees of the insured.
2. Liability arising out of the use of mechanically propelled vehicles whilst required to be compulsorily insured by legislation in respect of such vehicles.
3. Liability in respect of predetermined penalties or liquidated damages imposed under any contract entered into by the insured.
4. Liability in respect of loss or damage to property in the care, custody and control of the insured but this exclusion is not to apply to all property belonging to the Authority/Trust which is in the care, custody and control of another Insured Party.
5. Liability arising out of technical or professional advice (given for a fee) other than in respect of death or bodily injury to persons or damage to third party property.
6. Liability arising from the ownership, possession or use of any aircraft or marine vessel.
7. Liability arising from seepage and pollution unless caused by a sudden, unintended and unexpected occurrence.
8. Losses under the property damage policy or business interruption policy.

## Part 3

### Endorsements<sup>102</sup>

Unless the context otherwise requires defined terms set out in the following endorsements shall have the meaning set out in the Contract.

#### Endorsement 1

##### Cancellation

This policy shall not be cancelled or terminated before the original expiry date is to take effect except in respect of non-payment of premium.

The insurer shall by written notice advise the Authority:

- (a) at least 30 days before any such cancellation or termination is to take effect;
- (b) at least 30 days before any reduction in limits or coverage or any increase in deductibles is to take effect; and
- (c) of any act or omission or any event of which the insurer has knowledge and which might invalidate or render unenforceable in whole or in part this policy.

#### Endorsement 2

##### Multiple Insured/Non-Vitiation Clause

Each of the parties comprising the insured shall for the purpose of this policy be considered a separate co-insured entity, insured on a composite basis, with the words "the insured" applying to each as if they were separately and individually insured provided that the total liability of the insurers under each section of this policy to the insured collectively shall not (unless the policy specifically permits otherwise) exceed the limit of indemnity or amount stated to be insured under that section or policy. Accordingly, the liability of the insurers under this policy to any one insured shall not be conditional upon the due observance and fulfillment by any other insured party of the terms and conditions of this policy or of any duties imposed upon that insured party relating thereto, and shall not be affected by any failure in such observance or fulfillment by any such other insured party.

It is understood and agreed that any payment or payments by insurers to any one or more of the insureds shall reduce, to the extent of that payment, insurers' liability to all such parties arising from any one event giving rise to a claim under this policy and (if applicable) in the aggregate.

Insurers shall be entitled to avoid liability to or (as may be appropriate) claim damages from any insured party in circumstances of fraud misrepresentation non-disclosure or material breach of warranty or condition of this policy (each referred to in this clause as a "Vitiating Act") committed

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<sup>102</sup> The endorsements in this Part 3 of Annex 5 is recommended drafting. Whilst the parties should endeavour to obtain cover in accordance with these wordings, if these are not in practice available, the parties should obtain the best terms reasonably available in the market at the time.

by that insured party save where such misrepresentation non-disclosure or breach of warranty or condition was committed innocently and in good faith.

For the avoidance of doubt it is however agreed that a Vitiating Act committed by one insured party shall not prejudice the right to indemnity of any other insured who has an insurable interest and who has not committed the Vitiating Act.

Insurers hereby agree to waive all rights of subrogation and/or recourse which they may have or acquire against any insured party (together with their employees and agents) except where the rights of subrogation or recourse are acquired in consequence of a Vitiating Act in which circumstances insurers may enforce such rights against the insured responsible for the Vitiating Act notwithstanding the continuing or former status of the vitiating party as an insured.

Notwithstanding any other provision of this policy or any other document or any act and/or omission by any insured party insurers agree that:

(1) no party other than the Authority has any authority to make any warranty, disclosure or representation in connection with this policy on behalf of the Authority;

(2) where any warranty, disclosure or representation is required from the Authority in connection with this policy insurers will contact the Authority in writing (in accordance with Endorsement 3 to the Contract) and set out expressly the warranty, disclosure and/or representation required within a reasonable period of time from the Authority (regarding itself); and

(3) save as set out in a request from insurers to the Authority in accordance with (2) above, the Authority shall have no duty to disclose any fact or matter to insurers in connection with this policy save to the extent that for the Authority not to disclose a fact or matter would constitute fraudulent misrepresentation and/or fraudulent non-disclosure.

### **Endorsement 3**

#### **Communications**

All notices or other communications under or in connection with this policy shall be given to each insured (and the Authority) in writing or by facsimile. Any such notice will be deemed to be given as follows:

- (a) if in writing, when delivered;
- (b) if by facsimile, when transmitted but only if, immediately after transmission, the sender's facsimile machine records a successful transmission has occurred.

The address and facsimile number of the Authority for all notices under or in connection with this policy are those notified from time to time by the Authority for this purpose to the Contractor at the relevant time. The initial address and facsimile number of the Authority are as follows:

1. The Authority:  
Address:

Facsimile No: [ ]

Attention: The Chief Executive from time to time of  
the Authority

It is further agreed that a notice of claim given by the Authority or any other insured shall in the absence of any manifest error be accepted by the insurer as a valid notification of a claim on behalf of all insureds.

**Endorsement 4**

**Loss Payee (applicable only to the Physical Damage Policies)**

Subject to the provision of Clause [24.5(b)] all proceeds of this policy shall be payable without deduction or set-off to the Joint Insurance Account.

**Endorsement 5**

**Primary Insurance**

It is expressly understood and agreed that this policy provides primary cover for the insured parties and that in the event of loss destruction damage or liability covered by this policy which is covered either in whole or in part under any other policy or policies of insurance effected by or on behalf of any of the insured parties the insurers will indemnify the insured parties as if such other policy or policies of insurance were not in force and the insurers waive their rights of recourse if any against the insurers of such other policy or policies of insurance.

**Endorsement 6**

**Ringfencing**

The level of any indemnity available to an insured party under this policy in relation to any claim(s) concerning the Project shall not be affected and/or reduced by any claim(s) unrelated to the Project.

## Part 4

### Broker's Letter of Undertaking<sup>103</sup>

To: The Authority

Dear Sirs

Agreement dated [ ] entered into between [ ] Limited (the "Contractor") and [ ] (the "Authority") (the "Agreement")

1. We refer to the Agreement. Unless the context otherwise requires, terms defined in the Agreement shall have the same meaning in this letter.
2. We act as insurance broker to the Contractor in respect of the Required Insurances and in that capacity we confirm that the Required Insurances which are required to be procured pursuant to clause [ ] and schedule [ ] of the Agreement:
  - 2.1 where appropriate name you and such other persons as are required to be named pursuant to the Agreement for their respective interests;
  - 2.2 are, in our reasonable opinion as insurance brokers, as at today's date, in full force and effect in respect of all the matters specified in the Agreement; and that
  - 2.3 all premiums due to date in respect of the Required Insurances are paid and the Required Insurances are, to the best of our knowledge and belief, placed with insurers which, as at the time of placement, are reputable and financially sound. We do not, however, make any representations regarding such insurers' current or future solvency or ability to pay claims; and that
  - 2.4 the endorsements set out in **Part 3 to Schedule [ ]** of the Agreement are as at today's date in full force and effect in respect of the Required Insurances.
3. We further confirm that the attached cover notes confirm this position.
4. Pursuant to instructions received from the Contractor and in consideration of your approving our appointment [or continuing appointment] as brokers in connection with the Required Insurances, we hereby undertake in respect of the interests of the Authority in relation to the Required Insurances:

#### 4.1 Notification Obligations

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<sup>103</sup> The wording in this Part 4 of Annex 5 is recommended drafting. If agreement to this wording is not in practice achievable, then the parties should agree the best terms reasonably available in the market at the time.

**4.1.1** to notify you at least 30 (thirty) days prior to the expiry of any of the Required Insurances if we have not received instructions from the Contractor to negotiate renewal and in the event of our receiving instructions to renew, to advise you promptly of the details thereof;

**4.1.2** to notify you at least 30 (thirty) days prior to ceasing to act as brokers to the Contractor unless, due to circumstances beyond our control, we are unable to do so in which case we shall notify you as soon as practicable; and

**4.1.3** to pay into the Joint Insurance Account without set off or deduction of any kind for any reason all payments in respect of claims received by us from insurers in relation to the Required Insurances specified in **Clause [24.5]** of the Agreement.

## **4.2 Advisory Obligations**

**4.2.1** to notify you promptly of any default in the payment of any premium for any of the Required Insurances;

**4.2.2** to notify you if any insurer cancels or gives notification of cancellation of any of the Required Insurances, at least 30 (thirty) days before such cancellation is to take effect or as soon as reasonably practicable in the event that notification of cancellation takes place less than 30 (thirty) days before it is to take effect;

**4.2.3** to notify you of any act or omission, breach or default of which we have knowledge which in our reasonable opinion may either invalidate or render unenforceable in whole or in part any of the Required Insurances or which may otherwise materially impact on the extent of cover provided under the Required Insurances; and

**4.2.4** to advise the Contractor of its duties of disclosure to insurers and to specifically advise upon:

**4.2.4.1** the facts, circumstances and beliefs that should generally be disclosed to insurers; and

**4.2.4.2** the obligation not to misrepresent any facts, matters or beliefs to insurers.

## **4.3 Disclosure Obligations**

**4.3.1** to disclose to insurers all information made available to us from any source and any fact, change of circumstances or occurrence made known to us from any source which in our reasonable opinion is material to the risks insured against under the Required Insurances and which properly should be disclosed to insurers as soon as practicable after we become aware of such information, fact, change of circumstance or occurrence whether prior to inception or renewal or otherwise; and

**4.3.2** to treat as confidential all information so marked or otherwise stated to be confidential and supplied to us by or on behalf of the Contractor or the Authority and not to disclose such information, without the prior written consent of the supplier, to any third party other than those persons who, in our reasonable opinion have a need to have access to such information from time to time, and for the purpose of disclosure to the insurers or their agents in respect of the Required Insurances in discharge of our obligation set out at clause 4.3.1 of this letter. Our obligations of confidentiality shall not conflict with our duties owed to the Contractor

and shall not apply to disclosure required by an order of a court of competent jurisdiction, or pursuant to any applicable law, governmental or regulatory authority having the force of law or to information which is in the public domain.

#### **4.4 Administrative Obligations**

**4.4.1** to hold copies of all documents relating to or evidencing the Required Insurances, including but without prejudice to the generality of the foregoing, insurance slips, contracts, policies, endorsements and copies of all documents evidencing renewal of the Required Insurances, payment of premiums and presentation and receipt of claims;

**4.4.2** to supply to the Authority and/or its insurance advisers (or the Authority's or its insurance advisers' authorised representatives) promptly on written request copies of the documents set out in clause 4.4.1 of this letter, and to the extent available, to make available to such persons promptly upon the Authority's request the originals of such documents;

**4.4.3** to administer the payment of premiums due pursuant to the Required Insurances such that, in so far as we hold appropriate funds, all such premiums shall be paid to insurers in accordance with the terms of the Required Insurances;

**4.4.4** to administer the payment of claims from insurers in respect of the Insurances (the "Insurance Claims") including:

**4.4.4.1** negotiating settlement of Insurance Claims presented in respect of the Required Insurances;

**4.4.4.2** collating and presenting all information required by insurers in relation to Insurance Claims presented in respect of the Required Insurances, and

**4.4.4.3** insofar as it is relevant and practicable, liaising with and reporting to each Authority throughout the settlement, payment and administration of such Insurance Claims.

**4.4.5** to advise the Authority promptly upon receipt of notice of any material changes which we are instructed to make in the terms of the Required Insurances and which, if effected, in our opinion as Insurance Brokers would result in any material reduction in limits or coverage or in any increase in deductibles, exclusions or exceptions;

**4.4.6** to advise the Authority in advance of any change to the terms of, or any lapse, non-renewal and/or cancellation of any policy maintained in respect of the Required Insurances; and

**4.4.7** to use our reasonable endeavours to have endorsed on each and every policy evidencing the Required Insurances (when the same is issued) endorsements substantially in the form set out in **part 3 to schedule []** of the Agreement.

#### **4.5 Insurance Cost Reporting Procedures**

**4.5.1** to prepare following request, at the expense of the Contractor, a Joint Insurance Cost Report on behalf of both the Contractor and the Authority in accordance with the Insurance Review Procedure as set forth in [Section 24.8]

of the Agreement. We shall ensure that the information in the Joint Insurance Cost Report is fairly represented, based on the information available to us.<sup>104</sup>

**5. Notification Details**

- 5.1** Our obligations at clause 4 of this letter to notify or inform you shall be discharged by providing the requisite information in hard copy to:

[ ] Authority

- 6.** We shall supply further letters substantially in this form on renewal of each of the Required Insurances and shall supply copies of such letters to those parties identified to us by the Authority for such purposes.

Yours faithfully

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For and on behalf of [Contractor's broker]<sup>105</sup>

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<sup>104</sup> This provision under clause 4.5 is Required Drafting and may not be altered.

<sup>105</sup> The Contractor's broker may wish to limit its liability and include additional liability wording in the Broker's Letter of Undertaking. Whilst this is in principle acceptable, the Authority will need to check that (i) the scope of such additional wording is appropriate (eg does not extend to a limitation of liability for fraudulent acts), and (ii) the capped amount is set at a sufficiently high level.

## Part 5

### Definitions

**“Revenue”** is defined as the projected Unavoidable Fixed Costs and Senior Debt Service Costs of the Contractor.

**“Senior Debt Service Costs”** shall mean interest and debt service costs incurred in respect of the Senior Financing Agreements less

- (a) sums which are in arrears;
- (b) all sums reserved by the Contractor and which the Contractor is entitled to use to make such payments, without breaching the Senior Financing Agreements.

**“Unavoidable Fixed Costs”** should mean the fixed costs incurred by the Contractor which first fall due for payment by the Contractor during the period of indemnity but excluding:-

- (a) costs which could have reasonably been mitigated or avoided by the Contractor;
- (b) payments to the Contractor’s Associated Companies;
- (c) payments which are not entirely at arm’s length;
- (d) payments to holders of equity in the Contractor, Subordinated Lenders and any other financing costs other than Senior Debt Service Costs;
- (e) indirect losses suffered or allegedly suffered by any person;
- (f) fines, penalties or damages for unlawful acts, breaches of contract or other legal obligations;
- (g) payments the Contractor can recover under contract or in respect of which the Contractor has a remedy against another person in respect of the same liability;
- (h) payments to the extent that the Contractor has available to it
  - i. reserves which the Contractor can draw upon without breaching the Senior Financing Agreement;
  - ii. standby or contingent facilities or funds of Senior Debt or equity which the Contractor is entitled to have available;
- (i) payments representing any profits of the Project (to the extent not already excluded in (e) above).