



# RESPECT THE UNEXPECTED

How firms can mitigate their exposures to delays and cost overruns.

By Carl Spensieri

Canada has an infrastructure problem. According to the 2016 Canadian Infrastructure Report Card, \$141 billion of existing Canadian infrastructure is in very poor or poor condition. Put another way, each Canadian household must contribute \$20,000 to address current infrastructure replacement and construction needs. Unfortunately, these estimates do not account for cost overruns—and experience suggests they should.

Numerous studies examining the occurrence of costs overruns have been undertaken in multiple jurisdictions throughout the world. See page 24 for detail on a recent report by Matti Siemiatycki

outlining the causes of cost overruns in mega-projects. The paper cited that nine out of 10 global transportation projects valued at \$100 million or more experience average cost overruns of 28 per cent. Public-private partnerships (P3s) have emerged as a leading design, build, finance, operate, and maintain procurement model to deliver complex infrastructure projects on-time and on budget. Given taxpayers have little patience for cost overruns and delays, all levels of government will increase the number of projects delivered using the P3 model.

With the financial risk of delay and cost overruns transferred to the private

sector, how do contractors, designers, and lenders mitigate their exposures? This article examines the role insurance plays in mitigating cost overruns and delays. Specifically, we will examine the use of environmental insurance and discuss how specific covers and carrier claim response can reduce or eliminate certain financial risks.

## Project pollution policy

Canada is widely recognized as a leader in the use of P3s, so the Canadian insurance industry has responded by developing innovative and bespoke insurance products. The project pollution policy is an innovative

insurance product designed to address the pollution exposures of both private (designer, contractor, lender, and operator) and public (sponsoring municipality or government agency) stakeholders. To illustrate how, let us examine two covers: first-party pollution liability; and accelerated cleanup costs.

**First-party pollution liability:** Traditionally, project construction risk was mitigated by purchasing an owner or contractor-controlled pollution policy. These previous generation policies required a claim brought by the project owner against the main contractor or a subcontractor to trigger cover. The use of owner or contractor-controlled pollution policies is inappropriate for P3s because of the inherent delays associated with bringing a claim and critical gaps in cover. Specifically, it may take the project owner days or weeks

the risk of unanticipated cost overruns. By eliminating the need for “claims,” the project pollution policy also maintains positive working relationships between the project owner and main contractor.

**Accelerated cleanup costs:** Encountering unanticipated contaminants at a job site can create significant project delays and cost overruns. Traditional pollution insurance products only offer cover for the cleanup of contaminants arising from construction. The project pollution policy offers two additional covers: cleanup for contaminants “discovered” at or migrating from the project site; and accelerated cleanup. The first enhancement transfers the financial risk associated with encountering unanticipated contaminants from the P3 stakeholders to the insurance carrier. The second enhancement minimizes project delays. Under a traditional owner or

with construction, the project is further delayed. To minimize delays, stakeholders spend significant effort ensuring the necessary resources are pre-identified and immediately available. For example, an environmental consultant familiar with the project site might be retained at project inception. This allows the initial investigation to be undertaken quickly. In the same way, cleanup can be executed efficiently if laboratories, transportation, and waste management resources are all pre-identified. Unfortunately, poor carrier claim response can quickly undo forethought and planning resulting in project delay and even financial impairment.

Before purchasing insurance, stakeholders need to evaluate two critical capabilities: accessibility (where is the claim team located) and authority. Having a local decision-maker is preferable to someone out of country or overseas. The individual should also have the authority to make decisions and approve expenses without needing to seek approval. When someone out of country (or worse, overseas) needs to be involved, delays ensue because of scheduling conflicts, time needed to understand local requirements, and time change. Evaluating a carrier’s authority also means understanding the process by which a carrier evaluates the feasibility of a cleanup plan and obtains approval for its cost. If the carrier needs to assemble a quorum of decision makers or seek approvals from out of country or an overseas head office, delays should be expected.

Considering every day of delay can cost tens to hundreds of thousands of dollars (or far more if a critical project delivery date is missed), it is important to evaluate the carrier’s claim response. Failing to select an insurance carrier with claim response capabilities matched to the project risk can cost as much or more than failing to purchase adequate insurance cover. ✦

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to assemble the necessary information to make a formal claim against a contractor and provide notice to the insurance carrier. This in turn may cause a project delay if construction must stop until the pollution is addressed. In addition, these traditional pollution policies offer no cover when the pollution is caused by the project owner. For example, a light-rail transit project may require the project owner (the rail operator/authority) to undertake minor site preparation work. If the project owner causes a pollution event, traditional insurance products will not respond (the project owner cannot claim against itself) and the cost of the pollution event is treated as a cost overrun.

The project pollution policy addresses the above noted shortfalls by providing first party pollution liability cover. Specifically, the discovery of a pollution event by the project owner or main contractor is sufficient to trigger cover and require the insurance carrier to address the pollution event. This saves critical time as the project owner does not need to prepare and file a formal claim. The breadth of the insuring agreement also ensures pollution events caused by the project owner are covered, reducing

contractor-controlled pollution policy, the carrier is able to undertake cleanup using techniques of its own choosing. If the carrier elects to use risk assessment, the project will be delayed by the time needed complete the necessary investigations and obtain government approvals. These delays are eliminated by accelerated cleanup cover, as the insurance carrier is obligated to undertake cleanup using the shortest viable method. This minimizes project delay, which in turn minimizes the financial risk to all stakeholders associated with missing contractual delivery dates.

### Carrier claim response

Carrier claim response is a crucial but often ignored consideration when making an insurance purchase. While claim response is difficult to characterize in a quantitative way, it directly impacts the risk of project delay and financial impairment. To understand how, let us imagine contaminated soils are discovered while excavating the foundations of building. Pursuant to environmental protocols, the contractor halts work. The project is delayed by the time required to engage a consultant, investigate, and develop a cleanup plan. If cleanup cannot be undertaken concurrently



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**FOR MORE:** Read about the potential pollution liabilities renewable projects face on **page 30**.