THE INSURANCE Insider

Energy construction market braces for $1.4bn Ichthys losses

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22/02/2019

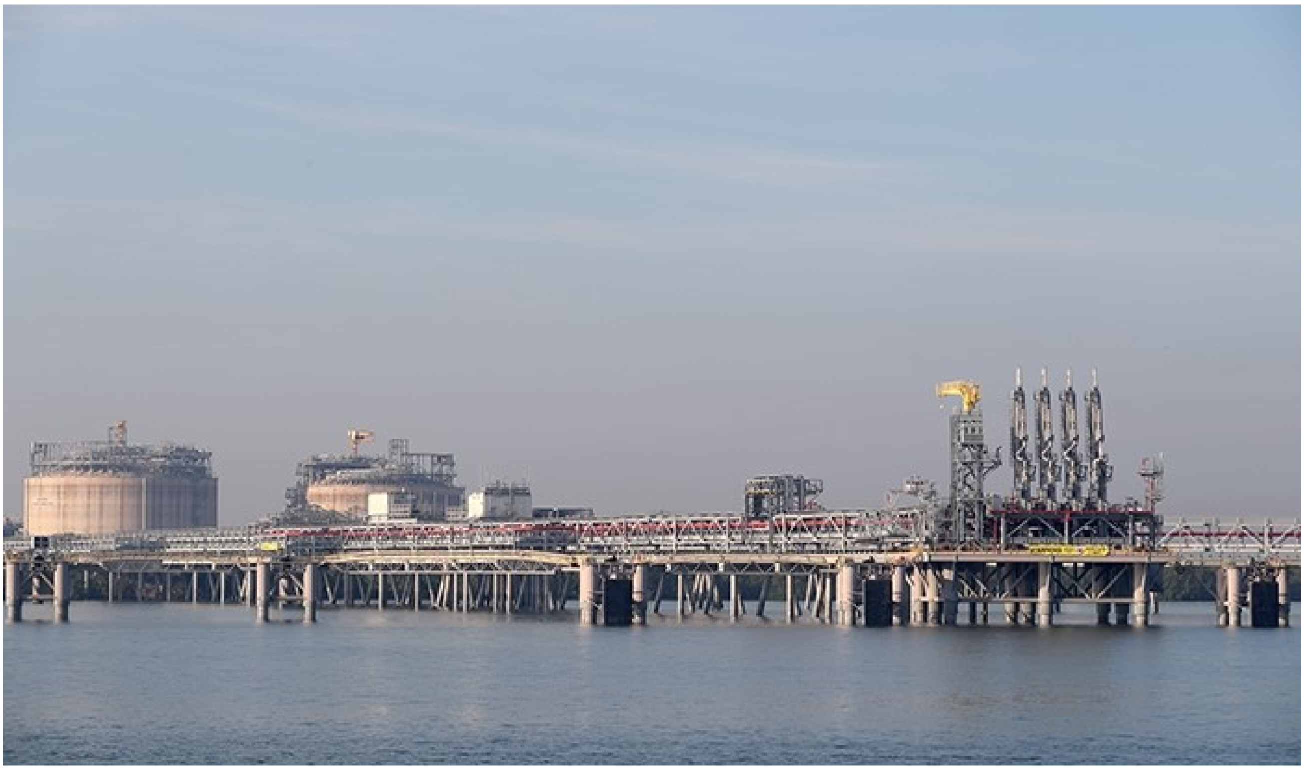

Photo: PA

Underwriters in the energy construction market are expecting to pay out at least AS$2bn ($1.42bn) after the operator of one of the world's largest energy projects filed two separate claims on its erection all-risks (EAR) policy, *The Insurance Insider* can reveal.

The Icthys liquefied natural gas (LNG) project is based in Darwin, capital of Australia's Northern Territory. Japanese energy group Inpex has put carriers on notice for claims following multiple problems relating to the onshore component of the LNG extraction project.

The policy set to respond is led by AIG and brokered by Aon Australia out of London. Other markets on risk are understood to include Zurich.

Market sources said each loss was likely to cost at least $700mn, but that the final quantum could be higher.

Combined, the losses are one of the largest claims to hit the insurance market in the last five years. They are also one of the biggest ever for the energy construction market.

Market sources said the two claims filed so far relate to the application of faulty paintwork and fire-retardant coating during the construction of the onshore portion of Icthys.

The LNG extraction project was launched in 2012 as a joint venture between Inpex, Total, CPC Corporation Taiwan and the Australian subsidiaries of Tokyo Gas, Osaka gas, Kuwait Electric Power, Jera and Toho Gas.

Construction cover for the project is understood to be split across two separate insurance placements covering onshore risks and offshore risks.

According to sources, insurance for the project is set to renew on 1 June, raising questions about pricing and the availability of cover.

EAR insurance covers the erection and installation of electrical or mechanical plants. The policies are usually provided for power plants, oil and gas facilities and other heavy industries.

The extent of cover provided by the EAR policy held by Inpex is not clear, but multiple sources said it was likely the project holds a policy that includes a London Engineering Group wording known as LEG 3.

The widely used LEG 3 gives insureds a higher level of cover than LEG 2 or LEG 1.

Under the wording, insurers are usually liable to pay for unforeseen and sudden physical loss or damage – but not the cost of replacing or rectifying original designs.

Technical issues have hampered construction of both the onshore and offshore segments of Icthys, which has so far cost investors about $44.8bn.

Market sources expressed concerns when the Australian energy regulator identified serious deficiencies in electrical installations across the Ichthys Explorer platform, which is part of the offshore segment of the Ichthys project.

However, no claim has yet been filed on the project's offshore EAR placement, only the onshore piece.

Energy construction is a specific class of marine business that spans both the energy and construction markets.

Contractors' All Risks (CAR) and EAR policies are usually taken out as part of cover known as project insurance.

The project insurance market recorded global premiums of about $50bn, according to Swiss Re's Sigma report.

Recent notable losses in the sector include a $1.28bn claim on a construction policy in 2017 relating to physical damage at a North Sea mobile offshore production unit (Mopu).

Dutch-based offshore energy specialist Single Buoy Mooring sought indemnity for damage to the Mopu unit in the Norwegian sector of the North Sea after the discovery of a deficiency in the structure prompted its removal.

The loss prompted a major legal fight after SBM claimed a constructive total loss under each of the all-risk policies on the placement.

Later in 2017, most insurers on the primary layer of the risk settled with the offshore energy contractor for $247mn.

The Ichthys project losses come amid a string of recent claims in the construction, downstream energy and marine insurance markets over the last six months that have forced up rates and pushed carriers to withdraw.

These include a loss on the Ituango Dam in Colombia that is currently the largest loss in construction history and could reach $2bn.

Quoted premiums for US and international CAR placements have registered increases of between 5 percent and 30 percent.

In the UK, rate increases of between 30 percent and 100 percent have been widely seen.

The rate rises in the UK are linked to a heavy cull of London capacity over the past six months.

Lloyd's players including Beazley, Talbot, Acappella and CNA Hardy have all pulled out of the market.

Others such as Tokio Marine Kiln and StarStone have drastically scaled back line sizes and risk appetites, while Brit dropped its London-based underwriting team but continues to write construction in other markets.

The Icthys project is part of a $200bn LNG construction boom in Australia that, in November, turned Australia into the world's largest exporter of liquefied natural gas.

Aon and Inpex declined to comment.

AIG and Zurich did not respond to a request for comment.