International risk team

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The potential and perils of offshore wind

The Potential

A recent report by the IEA[1] has laid bare the impact of the Covid-19 pandemic on the energy industry. Demand for coal and oil plummeted as entire countries and industries went into lockdown in the first quarter of 2020. Renewable energy, however, bucked the trend and actually saw demand increase, primarily due to larger installed capacity and priority dispatch.

It is perhaps questionable whether that will be a short-term bounce. However, there are reasons to be hopeful that there now exists an opportunity for longer term change. One of the major reasons for the growth of the renewable energy industry in recent years has been sharp cost reductions driven by improvements in technology. The renewables industry has also been the main beneficiary of the decreasing acceptability of coal. If governments are serious about reducing carbon emissions, there may be no better opportunity to do so as they look to restart societies and economies in the coming months.

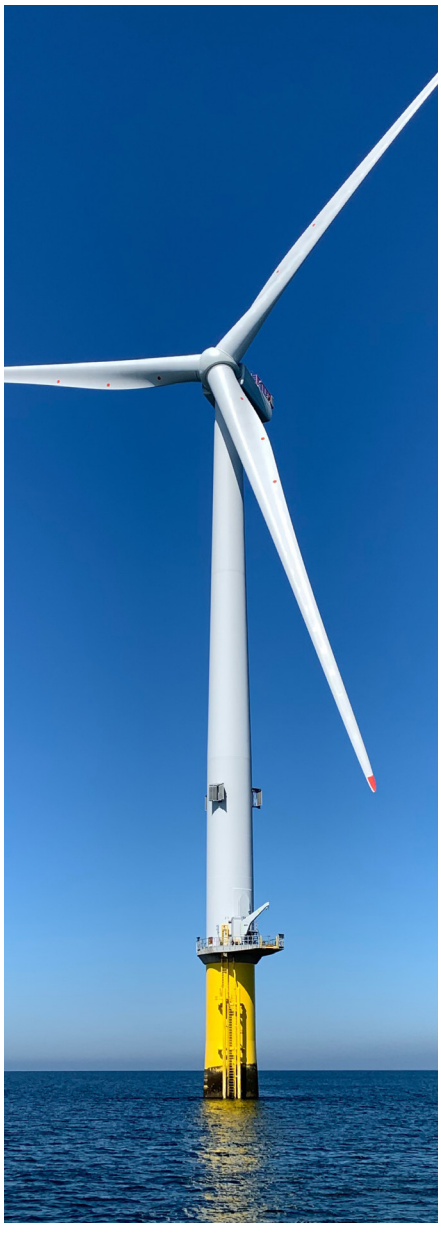
For obvious reasons, the renewables focus in the UK has very much been on wind power. In the most recent Queen's speech, the Government committed to 40GW of installed offshore capacity by 2030, and to enable new floating turbines[2]. Offshore wind is not just big business in the UK. There have been significant developments in both Germany and Denmark, and China added more capacity than any other country in 2018. The IEA reports that offshore wind *"...is set to expand strongly in the coming decades into a USD 1 trillion business."*[3]

The Perils

The boom in offshore wind obviously represents a fantastic opportunity for insurers, not least those who are looking to replace premium income from coal-based projects. However, the ever-developing technology and the nature of offshore wind farms also represent serious risks. The purpose of this article is to highlight some of those risks, and to stress the importance of attention to detail when it comes to policy wordings.

Historically, the most common types of losses in offshore wind involve (i) cables and (ii) foundations. Moreover, the most common causes of those losses are workmanship and design.

Modern windfarms often include hundreds of turbines. This means that not only is there a risk of, for example, defective design causing cracks in foundations, but also that when those problems do arise, they are often replicated numerous times. This is exactly what happened at the Robin Rigg offshore wind farm. In 2009, movement was discovered in the grouted connections of the foundations. It was subsequently found that the design standards used contained a fundamental error, which meant that all 60 turbines at the site required remedial works at a cost of €26.25m[4]. This obviously represents something of a recipe for disaster for all stakeholders, including insurers.



One way insurers can safeguard themselves is to ensure that effective aggregation language is included in their policies. For example, policies will normally be subject to a per occurrence deductible and limit, and the policy may provide that "*Occurrence means all covered loss, damage, or a sequence of losses or damages, casualties or disasters arising from an insured event.*" The intention of such language is to treat multiple losses as a single aggregated loss where they are sufficiently united by factors such as time, place, cause and human intent and action. However, the effect of such aggregation language is highly dependant on the specific facts of a given case. Additionally, in circumstances where instances of damage might occur and/or be discovered at different times, it might be difficult to argue that the so called 'test of unities' has been satisfied.

In recognition of the above, policies will often include a 'series loss clause' along the following lines:

"If an insured event resulting from (other than excluded herein) the development or discovery of a defect in design, plan, specification, materials or workmanship shall indicate or suggest that a similar defect exists elsewhere in the Property, the indemnity payable shall be as follows:

For the loss or damage associated with the first item of such Property: 100%

For the loss or damage associated with the second item of such Property: 75%

For the loss or damage associated with the third item of such Property: 50%

Further loss or damage to Property shall not be indemnified"

The basic intention of such clauses is that where multiple instances of damage arise from a common defect, insurers are liable on a sliding scale for the first few losses but have no liability thereafter. However, many issues arise with such clauses. For example, how 'similar' does the defect have to be, and how does one define where the defect begins and ends? Perhaps most importantly, where repairs are carried out to numerous turbines during one campaign, how do you go about splitting the cost of each instance of damage for the purposes of applying the relevant percentages?

As always, each claim will of course turn on its own facts and the particular wording used. However, if the energy insurance industry is going to maximise the prospects that renewable energy, and specifically offshore wind offers, insurers and brokers need to give proper consideration to the above and similar issues when drafting policy wordings. Failing to do so will mean disputes are likely to become increasingly common, which will only serve to diminish the opportunities on offer.

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Notes

1. www.iea.org/reports/global-energy-review-2020
2. assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/853886/Queen_s_Speech_December_2019_-_background_briefing_notes.pdf
3. www.iea.org/reports/offshore-wind-outlook-2019
4. *MT Hojgaard A/S v E.ON Climate and Renewables UK Robin Rigg East Ltd* [2017] UKSC 59

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