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Contractual risk management critical for renewable projects’ insurability

The renewable energy industry is growing at a fast rate. According to the International Energy Agency, renewable energy capacity increased by 45% in 2020, led by 90% growth in global wind capacity.

Renewable power and regeneration costs have fallen sharply over the last decade, shifting regulatory frameworks that support decarbonisation, and evolving consumer attitudes all continue to contribute to increased renewable energy use. In fact, in the spring of 2020, renewable generation in the UK reached record levels and contributed a 43.1% share of generation, outpacing for the first time annual fossil fuel generation.

But as investments grow and the industry matures against a backdrop of rising insurance prices and tougher terms and conditions, securing the right coverage for a project, or portfolio of projects is becoming more challenging. Insurer underwriting scrutiny — often involving a more engineering-based approach — is making contractual risk management and allocation critical to a renewable energy project's success. This is in terms of securing an equitable risk allocation and also obtaining acceptable insurance cover for all parties, including lenders, if necessary.

Contractual risk management: long-term considerations

The life of a renewable energy project can span many years and involve multiple contracts with disparate entities. Most contracts, including those with lenders, stipulate specific insurance requirements that can be impacted by shifts in the market over the lifetime of a project.

As financing contracts are generally finalised well before work on a project starts and insurance coverage is put in place, renewable energy asset owners and developers can find that insurance conditions included in contracts at inception are no longer consistent with what is commercially available, as the project progresses through its operational phase. They can also find that the cost of required insurance coverage is prohibitively expensive.

At the same time, underwriters are under pressure to write a profitable book of renewable energy projects and are therefore applying increased scrutiny to projects, which extends beyond the renewable energy asset owners and developers to contractors, suppliers, and manufacturers. Insurers are carefully examining all contracts related to a specific project, paying particular attention to:

- Insurance requirements for individual contractors.
- Indemnification language.
- Warranties and guarantees.
- Extreme weather protection clauses.
- Technologies used.

In making underwriting decisions, insurers may also consider the experience and reputation of individual contractors and subcontractors that are contracted to the project.

Renewable energy asset owners and developers that demonstrate greater risk management maturity are typically able to access more favourable coverage and financing options for their projects. Sophisticated renewable energy asset owners and developers proactively engage with insurance and risk management advisers throughout the contract cycle to gain better understanding of whether insurance terms included in contracts remain commercially available and reasonable.

Engaging with an experienced broker early in the process provides the opportunity to introduce language that supports greater flexibility in the face of market fluctuations over the life of an asset or contract. In addition, a thorough and detailed review of contracts — performed by specialised risk and insurance advisers — may identify potential hurdles related to insurance requirements and procurement further down the road.

Early risk identification and mitigation strategies

Over the lifetime of a renewable energy project, renewable energy asset owners and developers must identify and prepare for a number of emerging risks. As extreme weather events increase in frequency and severity, renewable energy asset owners and developers should adopt strong risk mitigation tactics to better manage and mitigate potential hazard exposures, which can lead to physical damage and possibly subsequent financial losses.

When it comes to wildfire risk, for example, lenders and insurers are now carefully analysing site selection, companies' fire protection and vegetation management strategies, as well as technologies used to remotely monitor areas of concern in real time. Additionally, details of engagement with local firefighting services are now often required. Similar scrutiny is being applied to other perils, with both lenders and insurers inquiring about risk mitigation strategies that are being applied to protect project sites.

Tactics to improve risk mitigation efforts

Some of the more mature renewable energy companies are engaging experienced professionals to conduct advanced modelling, including thorough preliminary natural catastrophe screenings, to identify location-specific challenges. These efforts can lead to more accurate risk assessments and potential cost-savings. Risk engineers, for example, can advise on design changes to reduce potential risks, such as increasing elevations of critical infrastructure in areas prone to flood risk.

Advanced engineering and modelling strategies can help reduce natural catastrophe risks. An experienced broker can offer analytics and budgeting tools to help renewable energy asset owners and developers better understand costs and benchmark against peers.

Companies that proactively engage a broker — before plans and contracts are finalised — can discuss budgeting for construction and operation phases. By providing an estimate of insurance costs and potential challenges related to securing coverage for certain locations, insurance brokers and risk advisers can help asset owners make confident decisions on the profitability of building a project in a specific location. Overall, this allows them to identify issues and trends that might pose concerns or necessitate closer examination.

Engaging professionals early in the project lifecycle is vital to successful risk identification and mitigation, allowing renewable energy asset owners and developers to make informed changes to reduce risks. Risk mitigation can have a substantial impact on the insurability of a project, potentially increasing insurer appetite for a given asset, reducing coverage costs, and increasing the asset's profitability.

How to overcome insurability concerns

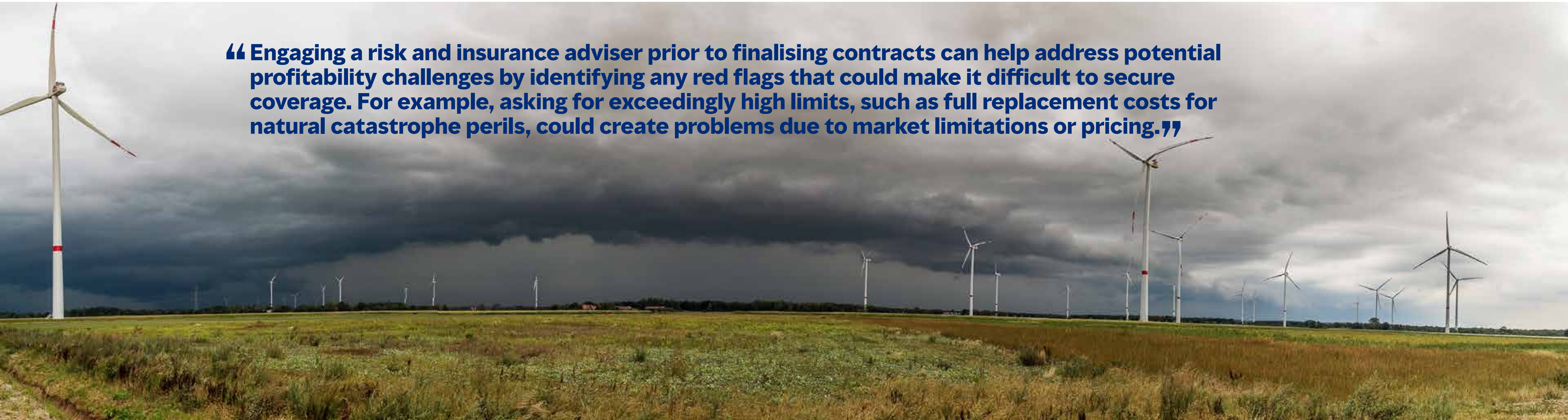
A major concern for renewable energy asset owners and developers is managing costs, and insurance tends to make up a substantial portion of overall project expenses, in particular during the operational phase. When finalised contracts include specific insurance requirements that have become difficult to secure, the associated costs can escalate.

To overcome insurability challenges, a broker can support the development of standard terms and conditions for a renewable energy asset owners and developers, and establish a clear strategy on deductibles and limits. When all parties understand current requirements, your broker can effectively communicate with key insures, helping promote clarity in negotiations with insurers and support a streamlined claims process.

Strong contractual risk management: the key to success

Demonstrating diligence in managing contractual risk sends a message to suppliers, vendors, and contractors that your organisation has a sophisticated risk management strategy, which can contribute to better results for all parties. The market is already experiencing a level of consolidation, with lenders aggregating the more attractive assets. Companies that are able to achieve scale will be in a better position to reduce costs, placing them in a more attractive position to secure both financing and insurance.

As the renewable energy market continues to expand, and more players enter the field, companies with sophisticated risk mitigation strategies and a considered approach to securing financing are more likely to succeed.



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