

Erection insurance

# Insurance coverage for the construction of a power plant – optimization of standard clauses

## 1. INTRODUCTION

The construction of a power plant usually implies investments in the amount of three-digit millions. The technical risks threatening during the construction of the power plant which may cause financial losses are immense. The insurance industry offers contract standards for the protection against technical risks. In so far as the policy holder adapts these standards via the insurance contract to the concrete power plant project in the tender and subsequent negotiation, an extensive transfer of the risks to an insurer (resp. to several insurers) is possible.

The following article deals with the necessary adaptations of standard clauses in the erection insurance – which is essential for the construction of power plants. The adaptations of insurance clauses described in this article are chosen exemplarily.

## 2. INSURANCE COVERAGE FOR THE CONSTRUCTION OF A POWER PLANT

During the construction of a power plant, the conclusion of several insurance contracts is reasonable.

It is advisable to conclude a building owner's liability insurance, which offers insurance coverage against legal liability claims resulting from breach of duties (e.g. bad signage, bad protection of building site) during the construction time.

The financial risks for the power plant project resulting from a delay of the completion, may be insured by policy holders through an Advance Loss of Profits-insurance („ALoP“) or a Delay in Start-Up-insurance („DSU“). An obligatory requirement for an ALoP- or DSU-insurance is a respective erection insurance.

For the construction of a power plant, the orderer (“orderer policy“) needs protection against damages occurring during the construction through erection insurance. The erection insurance offers insurance coverage during the entire phase of assembly and putting into operation, whereby all companies involved in the construction of the power plant are included into the insurance coverage. Since credit institutions request the conclusion of an erection insurance for the financing, the focus of this article will be on the erection insurance.

### **3. LEGAL NATURE OF THE ERECTION INSURANCE CONTRACT**

The erection insurance is a technical insurance offering insurance coverage against all kinds of dangers as an all-risk-policy, as long as this danger is not explicitly excluded from the insurance coverage. The all-risk-policy offers the policy holder (in case only a few exclusions are agreed) a comprehensive and easily understandable insurance coverage.

Both the policy holder's interests (as orderer of the assembly project) and all other companies involved in the assembly (among others the general contractor) are insured. This drafting as own- or third-party insurance contract has the consequence that the policy holder will always be entitled to request the insurance benefit from the insurers (cf. sections 43, 45 Insurance Contract Act “VVG“). Whether the ordering party (the orderer of the power plant) or the contractor (e.g. general contractor) will be entitled to the insurance benefit in the internal relationship is not relevant for the right to the claim towards the insurers.

### **4. SUBSTANTIATION OF CONTRACT CLAUSES**

The standard clauses of insurers for assembly projects need to be adapted to the particularities of the construction of a power plant. The standard insurance terms for erec-

tion insurance contracts (AMoB) of the general association of the German insurance industry (“GDV”) do not offer sufficient insurance coverage for the construction of a very expensive and technically complex power plant. There are only a few decisions of the Supreme Court and some commentary literature about the risks during the assembly of a power plant.

Therefore, the policy holder and the erection insurer will partly delete or substantiate some standard clauses from the AMoB during contract negotiations and define individual terms in order to offer sufficient insurance coverage for power plant constructors, general contractors, subcontractors etc.

#### 4.1 Substantiation of the insurance definition

The uniform insurance case definition about technical insurance contracts according to the GDV is also found in the standard clauses for the erection insurance (§ 2 AMoB):

*„The insurer pays compensation for unforeseen damage or destruction of insured property (property damage).*

*Damages are unforeseen that have not been detected early enough by the policyholder or its representatives, nor should have been foreseen even with the expertise necessary for the work performed, whereby only gross negligence harms.”*

This insurance case definition provides high conflict potential in the damage settlement if no substantiation and definition of vague legal terms requiring interpretation (property damage, unforeseen, representatives, gross negligence) are provided.

##### 4.1.1 Insufficient property damage definition

The central term in the insurance case definition according to sec. 2 AMoB is those of the property damage. This term is insufficiently defined in the insurance terms as “*damage or destruction*” of the insured property. In the insured event, this definition may cause unnecessary discussions among policy holders and insurers. Therefore it is reasonable to substantiate the damage term in the insurance terms.

For reason of clarification, the parties to the insurance contract could agree that property damage in the erection insurance is not only given if property substance impair-

ment is given. Also an impairment of the use capability of a property without a violation of the property substance may be a property damage.

Sufficient for being defined as damage is a mere function alteration or loss of function or impairment of the value of the insured property. Thus, e.g. pollution may be insured property damage.

Furthermore, the parties to the insurance contract may for reasons of clarification agree that the occurrence of the property damage does not require an external event, and even internal procedures may cause property damage.

Furthermore, the clarifying regulation makes sense, according to which a deficiency as the cause of damage does not preclude damage within the meaning of the insurance case definition.

#### 4.1.2 Unpredictable occurrence of damage

Another requirement for the occurrence of the insured event in the erection insurance is the unpredictability of the damage.

In order to avoid questions during damage settlement about whether damage occurred unforeseen, it makes sense to put undefined legal terms in the insurance contract in concrete terms. The insurance contract might clarify that the unpredictability of the occurrence of damage only refers to the subjective knowledge of the policy holder's representative (e.g. managing director of a GmbH or a board member of an AG) (so-called representative clauses).

Beyond that, the parties to the insurance contract should regulate whether the predictability of the damage shall have the effect that the insurance claim does not arise or only proportionally (following sec. 28 VVG).

#### 4.2 Exclusions

The standard clause according to the AmoB contain some exclusions from insurance coverage which are not acceptable for the construction of a power plant resp. require adaptation.

#### 4.2.1. First version risk

In sec. 2 cypher 3 AMoB the insurance coverage for the first version risk is reduced to the protection against damages from outside:

*„For damages to supplies and services, which the policy holder executes in this kind entirely or for the first time, the insurer pays indemnity, in so far as the damages were caused from the outside. In addition, the indemnity will only be paid if it had been particularly agreed.“*

The construction of a power plant is, due to constant technological advances, regularly combined with new services, performed for the first time. If the general contractor uses a new construction or a new concept of bringing the plant into operation, this would, according to an exclusion of the risk of first version, result in a reduction of insurance coverage. Internal operations which lead to a damage would not be insured.

Due to the necessity to realize technological advances when constructing a power plant, the policy holder can usually not accept the exclusion of the first version risk. Insurers are often willing to eliminate the exclusion of the first version risk.

#### 4.2.2 Exclusion of weather influences

The standard clauses according to the AMoB contain an exclusion of damages resulting from weather influences (sec. 2 cypher e) AMoB):

*„The insurer will not provide compensation for damages or losses as a direct result of normal weather influences, regardless of contributory causes, which are to be expected due to the season and the local conditions.“*

The construction of a power plant takes several years and passes through different weather conditions. An exclusion of weather influences as provided in the standard clause of the AMoB is usually not acceptable for the policy holders.

An addition concerning the exclusion of weather influences in the following terms seems reasonable:

*„The damage is still insured if the weather influence was merely a contributing factor and not the sole cause of the damage or if the usual precautions against weather damage had been performed to the insured object.“*

Before contract conclusion, the policy holder should examine and eventually eliminate further exclusions which are regulated in the standard clauses according to the AMoB (trial operation, detection of damages during an inventory control etc.) or negotiate a wording suitable to their needs.

#### 4.3 Reinstatement costs

If an insured event in the erection insurance occurs unforeseen, without exclusions being opposed to the insurance coverage, the policy holder is entitled to reimbursement of the necessary reinstatement costs. Reinstatement costs are those costs which are needed to restore the power plant to the state it was directly before the occurrence of the insured event (sec. 11 cypher 1 AMoB).

The term “reinstatement costs” is a central term for the question, how much the policy holder’s claim in the erection insurance is. The term reinstatement costs is though only insufficiently defined in the insurance contract.

For clarification reasons, the parties to the insurance contract could regulate that not only construction work activities (such as for example drilling, sawing, welding) are considered insured reinstatement costs. All activities serving the preparation, execution, supervision and inspection of the reinstatement of the insured power plant (such as costs for the choice and supervision of repair companies, costs for the examination of repair invoices) are included in the term “reinstatement costs”.

For clarification reasons, the parties to the insurance contract could agree that also costs for the search for the cause of the damage and costs for the search for the extent of the damages are also included in the insured reinstatement costs.

Regular discussions arise about the question to which extent lump-sum overhead costs are part of the insured reinstatement costs. For clarification reasons, the parties to the insurance contract could agree on percentage mark-ups on the costs calculated for the compensation for insured overhead costs.

The policy holder is often interested in a quick repair of the damaged power plant. For this reason, the insurance terms should contain a provision, according to which long hours, extra work, additional freight etc. are insured.

## 5. CONCLUSION

It makes sense to conclude several insurance contracts for the construction of a power plant, whereby the erection insurance will usually be the most important insurance contract. Due to the legal nature of the erection insurance contract as all-risk-policy, erection insurance contracts often offer comprehensive insurance coverage for the construction and taking into operation of a power plant highly prone to damages.

Standard clauses according to the AmoB should always be examined as to whether they offer the comprehensive erection insurance coverage required for the construction of a power plant or whether a substantiation and individualization are required.

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