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Optimized insurance cover for machinery

Efficient machines are the basis of a successful production. With enhanced efficiency complexity and costs of machines increase. Damages to machines may have extensive financial consequences. When hedging this risk some details should be taken into account.

Companies transfer the risk of damages to their high-quality machines, plants and devices (hereafter “machines”) to insurers. By the conclusion of a machinery insurance contract, losses become calculable.

The machinery insurance is an all-risks insurance. In principle, this contract insures companies against almost all risks that can damage machines. Only risks that are excluded explicitly in the insurance contract are not insured.

Specify details in the contract as exactly as possible

Companies can insure machines, devices and all kinds of technical plants (e.g. power plants, wind energy plants) through machinery insurance contracts.

Machines consist of individual parts. In case of damage to a secondary system (e.g. a transfer station), a too general description of the machine (e.g. wind energy plant) can raise questions concerning the scope of insurance (e.g. whether the secondary system is insured). Generally the contract parties describe the insured item in detail in a machine directory. A specific description of the insured machine including all secondary systems avoids discussions about the scope of the insurance contract.

The machinery insurance grants insurance cover for all risks to a machine. Insurance cover is granted independent of the cause of damage. Thus, among others, damages due to handling errors, inexperience and third parties intent are insured.

The occurrence of property damage obliges the insurer to compensatory payment. The insured event requires that property damage to the machine occurs unexpectedly. The machine insurer does not replace financial losses.

Property damage is given, if the substance of a machine is affected that heavily, that the value and the usability of the insured item is at least diminished. So, for example, a crack or an incipient crack at the machine is an impairment of substance and therefore a property damage. Disfigurements, e. g. lacquer spallings that do not impair the usability of the machine are in contrast no property damage and do therefore not justify an insurance claim.

But in case a lacquer spalling at the rotor of a wind energy plant affects the rotation and thereby the technical usability, this is not only a disfigurement, but in fact a property damage.

The insurer does not pay in case of gross negligence

If the policy holder did not foresee the damage grossly negligently, there will be no or only a reduced insurance cover. A policyholder, who does not perceive the obvious and therefore disregards clear indications of a forthcoming damage and continues to use the machine until it is damaged, acts grossly negligently. However, insurance cover would have to be granted if the indications were hardly perceivable (minor negligence).

The cause of damage can remain unclear after the damage. The policyholder does not need to prove the cause.

No insurance cover against war and natural perils

The machinery insurance grants cover against all risks that could cause risks to machines. Only risks excluded by contract are not insured. The insurer has the burden of proof if he claims that an excluded risk caused the damage.

Usually, damages caused by war, civil war or revolution are excluded as well as natural perils such as flood or earthquakes. Companies which suffered damages to their machinery for example in the Libyan civil war or by the floods in Thailand in 2011 might be affected by this exclusion.

Also damages that result from the operational use of an insured machine are not insured. Break-downs are part of the entrepreneurial risk that the machine insurer usually does not cover. In case that an additional damage arises at adjacent parts of the machine as an indirect result of the break-down, insurance cover is granted.

Theft is not insured under the machinery insurance. However, if a burglar causes property damages to a machine by disassembling the stolen goods improperly, these damages are covered.

Insurance cover is place bound

The insurance location has to be specifically indicated in the insurance contract because only damages that occur there, are insured. This applies in particular, if the business premises are not identical with the policyholder's place of business. If the insurance policy only indicates the policyholder's place of business and the machine is not installed at the same address, the insurance cover could be endangered.

If the machine is outside of the insurance location (e.g. because of repair, revision or maintenance), no machinery insurance cover is granted. In this case, the policyholder should conclude a separate transport insurance.

After the occurrence of damage, insurers can terminate

The insurance cover period does not start until the agreed point of time and never before the machine is ready-to-use. This requires the successful testing of the machine. During the development phase, the erection insurance can provide insurance cover.

The insurance cover period might end due to termination after the occurrence of damage, because insurers examine the future damage potential of a machine after a damage and sometimes terminate depending on the examination. In this case, the policyholder has no insurance cover anymore. He often gets insurance cover at increased insurance premiums only due to the claims history.

To avoid such a situation, the contracting parties can exclude the right of termination in case of damage. Hereby the policyholder increases his planning certainty.

Insurer pays repair costs

The amount of the insurance payment depends on whether only a partial damage or a total loss arises. In case of partial damage to the machine, the insurer owes the rehabilitation costs. The rehabilitation costs correspond with the repair costs. The insurer can reduce these costs by the value of the salvage resulting from the repair. Furthermore, the insurer is allowed to make a "new for old" deduction.

Partial damage is given, if the rehabilitation costs plus the value of the salvage do not exceed the current value of the machine, i.e. the reinstatement value of the insured item less the loss of value due to wear and tear.

Insurance contracts often specify a maximum annual reduction of the time value. These contracts then arrange that the annual reduction of the reinstatement value must not be higher than 5 % of the reinstatement. In practice, this means that a machine with a reinstatement value of EUR 1 million in case of damage after a four-year-use at least has a current value of EUR 800,000.00 (5% reduction

of the time value per year x a four-year-use = 20% reduction of the reinstatement value). If, in the example above, the repair costs plus the value of the salvage are not higher than EUR 800,000.00, partial damage is given. The insurer owes repair costs in the amount of EUR 800,000.00 less the value of the salvage.

A total loss would be given, if rehabilitation costs were higher than the current value of the insured machine – in the present case for example EUR 900,000.00. In case of total loss, the insurer owes the policyholder at the maximum the current value of the insured item (in the example EUR 800,000.00).

The policyholder does not have to repair the machine. In this case, the insurer has to replace the objectively required sum which would arise for a fictive repair.

Protect against loss of production

The financial consequences of a loss of production due to a machinery breakdown regularly exceed the costs of the actual damage by far. Often companies do not bear in mind that machinery insurances do not protect against this risk. Such a misunderstanding can lead to consequences which may threaten the company's existence. The conclusion of an additional business interruption insurance can therefore be advisable. Managers should in any case examine in detail which insurance cover is needed for their company and where possible cover gaps arise.

Checklist:

Machinery insurance – what should be considered?

- Exact description of the machines to be insured and of the insurance location
- Minor negligence does not impair insurance cover – it should be clearly specified who acts on behalf of the policyholder
- The objection of the insurer that excluded risks caused the damage should be examined critically.
- The exclusion of the right of termination after a damage increases planning certainty
- The amount of insurance payment is based on the current value of the machine
- An additional conclusion of a business interruption insurance is advisable