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Industrial Insurance

How to demonstrate first party losses in industrial property insurance

1. INTRODUCTION

After the occurrence of an insured event, the policyholder in industrial property insurance often deploys own employees and/or uses own resources in order to compensate his losses. Accordingly, the policyholder requests the insurer to compensate the costs arising from such activities. The demonstration of the damage incurred, in this matter, becomes more difficult to establish than in circumstances where a third party removes the damage and issues an invoice.

In the following, we clarify some aspects the policyholder should keep in mind when requesting first party losses in industrial property insurance.

2. RESTORATION OF THE DAMAGED ITEM

In industrial property insurance, the insurer owes replacement or restoration of the damaged item. Sec. 88 Insurance Contract Act (“VVG”) defines the term of “insurable value” in property insurance. Accordingly, insurable value is the amount which the policyholder must spend upon occurrence of the insured event to replace or to restore the insured property to mint condition, minus the reduced market value resulting from the difference between old and new.

2.1 Partial loss or total loss

Whether the insurer owes restoration or replacement depends on the issue whether the damaged item is still restorable or not. Hence, a distinction has to be made between occurrence of partial loss and total loss. Total loss leads to reimbursement of all re-

placement costs or rather to reimbursement at the current market value of the damaged item.

Partial loss leads to full reimbursement of restoration costs. Total (economical) loss, however, also applies where restoration costs are significantly higher than the replacement costs at the current market value of the damaged item.

2.2 Scope of restoration

Restoration aims at bringing the damaged item back to a (technically) equivalent state (in comparison to its state of being just before the damage occurred). The former functionality, safety and the technical life expectancy are therefore relevant for restoration.¹ Some property insurance terms describe restoration costs for partial loss as costs that have to be spent in order to bring the item back to its previous condition just before the occurrence of the insured event.²

Apart from that, all further costs being subject to preparation and implementation of restoration measures are included as well.³ Such so called restoration accompanying measures (e.g. expenses for claims management, repair supervision in case of complex reparation issues, cost control, lease of land for storage of reparation materials etc.) form part of the replacement costs the insurer has to provide compensation for.

2.3 No compensation for financial loss

The insurer (in technical industrial property insurance) only has to compensate financial loss when the insurance contract provides for such exceptional compensation.

Financial loss relates to damage that neither results directly from damage to property (nor to personal injuries). Examples for financial losses are lost profits, loss of earnings,

¹ Cf. BGHZ 9, 195, 203f. with reference to AFB.

² E.g. sec. 7 no. 2 AMB 2008 („Wiederherstellung des früheren, betriebsfertigen Zustandes“); sec 8 no. 2 AMoB 2008 („Entschädigt werden alle notwendigen Aufwendungen für die Wiederherstellung des Zustandes unmittelbar vor Eintritt des Versicherungsfalls (...“).

³ Günther/Eckes in Münchener Kommentar zum VVG, 2010, Volume 1, Technical insurance, at no. 393.

tax disadvantages, higher insurance premiums, or failed (unsuccessful) investments. Financial losses are, however, generally covered under business interruption insurances.

3. DEMONSTRATION OF FIRST PARTY LOSS

The demonstration and enforcement of first party loss in industrial property insurance often turns out to be challenging.

This applies in particular with regard to complex losses, where the policyholder carries out part of the repair through his own employees and/ or resources. In some cases, the policy holder might even run the repair entirely through his own employees (e.g. in case a special facility constructed by the policyholder is concerned).

If the policyholder is involved in the repair he has to document his expenses for restoration in a judicious and comprehensive way. To meet the insurer's or rather a court's documentation requirements it is not sufficient to calculate own restoration costs on the basis of payroll accounting programs. In some cases, it may happen that the insurer accepts such evidence and adjusts the claim on that basis. However, if the policyholder sues against the insurer, he bears the burden of proof and evidence with reference to the amount of costs resulting from the first party loss. General (non-specific) evidence does not meet these requirements.

In the following, we examine three different kinds of damage that generally have to be taken into account when it comes to first party loss.

3.1 Use of own employees in order to restore damages

In case the policyholder deploys own employees in order to restore damages he should document as carefully as possible the number of hours worked. This includes the submission of hourly rates that are clear and comprehensibly. The expenses invoiced should be comparable to those charged by a third-party under market conditions.

3.1.1 Submission of hours worked

The policy holder should submit significant "classic" time sheets which (chronologically) reveal which employee, on which day, has rendered which service for which amount of time in order to restore the damaged item. In case the employee has to carry out different tasks for the policy holder that exceed damage repair, the time sheet should

specify which time entry stands for which task. The degree of necessary evidence is comparable to work descriptions requirements resulting from work or service contracts.

3.1.2 Amount of hourly rates

In respect of the invoiced hourly rates, the policyholder has to inform the insurer on which basis the hourly rates are calculated. By using his controlling devices the policyholder can usually determine the hourly rates of his employees that are calculated on an internal basis.

In contrast, the company's overhead costs generally does not form part of the hourly rates calculation. However, depending on the circumstances, job related overhead costs could be taken into account.

3.1.3 Arm's length principle

The insurer may contend against the duty to compensate replacement costs of the policyholder arising from the use of its own workers that the assignment of third party companies would have been cheaper. However, the insurer has to submit this in a substantiated way and, if applicable, prove it. In the event of a complex repair, such evidence could be provided through detailed cost estimate presentation issued by a competitor.

3.1.4 „Business-as-usual“ costs

In many cases, insurers submit that the replacement measures taken by the policyholder's own employees are so-called "business-as-usual" costs. Those costs would have arisen in any way regardless of the deployment of own employees for restoration needs.

Against that background, it is necessary that the policyholder submits or, if applicable, establishes evidence that, regardless of the restoration needs, his employees were busy with other tasks and orders and that other tasks were not processed or had to be passed to third parties.

Apart from that, the “business-as-usual” argument is not necessarily true. The Federal Court of Justice decided that the damaged party may repair the damage within its own company by deploying its own employees.⁴ The Court held that own efforts of the damaged party should not release the injuring party from its liability to compensate damage.

3.2 Use of own resources

The policy holder can make use of his own resources for the repair. Such resources are, for example, raw materials and commodities as well as electricity and gas.

The costs incurred are refundable within the scope of usual market prices. The policy holder, therefore, has to calculate the costs invoiced against the market prices. This can be done, for example, by submitting prices quoted on an exchange (for raw materials, electricity, gas) or by market comparison with comparable rents etc.

The policy holder is not obliged to invoice its own purchase prices if they are below market price. The insurer otherwise would benefit from the fact that the policyholder purchases goods below market price. The insurer shall not benefit from the policyholder's purchase skills or his purchasing power.

3.3 Charging restoration accompanying measures

In complex cases, restoration accompanying measures include a variety of different tasks which the policyholder fulfills within the scope of claims management. Restoration accompanying measures affect, for example, the commissioning of repairers and the controlling of deliveries and invoices. Besides, the application for repair related public licensing and approval falls into this category.

In case the policyholder renders such services connected to restoration needs by himself or through affiliated companies, he is allowed to charge the incurred costs. Working hours may be charged as mentioned under 3.1, if the policyholder deploys his own employees.

⁴ BGH (Federal Court of Justice) in: NJW 1980, 1518, 1519.

The (average) market price, here again, is the benchmark. In case the insurer submits that the costs invoiced are contrary to the market, the policyholder has to submit the relevant market standards and specific market remuneration.

4. SUMMARY

The demonstration of first party loss in property insurance requires greatest care. The degree of necessary documentation to the insurer thereby is the more convincing the more detailed the policyholder discloses information with regard to the amount of damage.

In order to avoid a subsequent difficult and time-consuming documentation, we suggest the policyholder right from the beginning to document carefully all expenses related to first party loss. Such effort will prove worthwhile in order to avoid extended disputes about the reimbursement and the amount of justified damage claims.

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