

Technical insurances

## INSURANCE COVER FOR MACHINES

### 1. INTRODUCTION

Companies transfer the risk of damage and destruction of their machines and plants to insurers. The machinery insurance makes financial impacts of damages to machines calculable.

The following article deals with the systematics and optimization of machinery insurance contracts under German law.

### 2. EXACT DESIGNATION OF INSURED MACHINES AND PLANTS

Companies insure machines and plants of all kinds (production plants, power plants, packaging machines, etc.) through machinery insurance. Tools and auxiliaries (e.g. fuels, lubricating oils) are usually not insured.

The machine (including components and accessories) should be designated exactly in the insurance contract. Machines often consist of thousands of individual parts. A general or inaccurate designation of the machine can raise questions about the extent of the insurance cover in case of damage to the accessories or to an auxiliary system of the machine ("Is the transmission station of the wind energy plant insured?"). The exact designation of the machine including accessories and all auxiliary

equipment avoids discussions about the extent of the insurance cover in the claims settlement between the policyholder and the insurer. For this reason, the machines are usually listed in detail in the so-called machine directories.

### 3. INSURED RISKS

According to Part A, sec. 2, cypher 1 of the German General Terms on Machinery Insurance 2011 ("AMB 2011"), machinery insurance provides cover for "unforeseen damages" to the machine.

Machinery insurance is a technical insurance contract. This **all-risk policy** secures companies against all risks that could damage the machine. Only risks explicitly excluded in the machinery insurance contract are not covered by the insurance.

The risks listed in the insurance terms AMB 2011 are examples for insured risks. The examples are not intended to provide a complete list. The terms include, among other things, "*damages due to operating errors, awkwardness, third parties' intent, construction-, material- and design-defects, short circuits, overcurrent and overvoltage*" as insured risks.

#### 4. OCCURENCE OF THE INSURED EVENT

The machine insurer has to perform when an insured event has occurred. The insured event occurs in case of an unforeseen damage to the insured machine.

##### 4.1 Damage

The damage has to be a material damage. Pursuant to the insurance terms, the property damage is imprecisely defined as "*damage or destruction of insured property*" (cf. Part A, sec. 2, cypher 1, para. 1, sent. 1 AMB 2011).

According to the standard contracts, the material damage is given if the machine is impaired in its substance and the value or the usability of the insured item is diminished. A fracture and/or crack (or a tear) on the machine are, for example, such substance impairments, which cause an insured material damage.

It is not necessary that the impairment of the substance can be detected easily with the naked eye for the damage to be an insured property damage. If, for example, after an acid attack, the resulting surface change on steel pipes of a machine can only be detected under a scanning electron microscope, there is nevertheless an impairment of the property substance and thus a material damage.

Beauty flaws which do not impair the technical function and/or the value of the machine, are not insured property damages (cf. Bruck/Möller about sec. 2 AMB, recital 8). If, for example, damages occur on the surface of the varnish of a nacelle of a wind power plant, this is no insured beauty flaw. If damage to the lacquer on the rotor though affects the rotating characteristic of the wind energy plant, the function is impaired as well. Consequently, the machine's technical usability is im-

paired. In this case, there is not only a beauty flaw, but also an insured property damage.

The machine-insurer does not reimburse any property damage (e.g. lost profit due to loss of production) without additional business interruption insurance.

##### 4.2 Unforeseen

The damage must have occurred unforeseen.

###### 4.2.1 Gross negligence harms

Damages are unforeseen which the policyholder neither anticipated nor could have foreseen in time, whereby only gross negligence and intent harm the insurance claim. Simple negligence remains without effect.

The gross negligence is to be examined on the basis of the specific circumstances of the individual case (cf. Bühren in Handbuch Versicherungsrecht, sec. 1 recital 305, Palandt about sec. 277 BGB, recital 2). General assertions, according to which supposedly typical conduct is always to be regarded as grossly negligent, are forbidden.

Only those policyholders act grossly negligent, who fails to exercise the reasonable care to a particularly high extent. The policyholder must disregard what would be obvious to every policyholder in a comparable situation. It must be a matter of absolutely inexcusable breaches of duty. The policyholder's conduct has to be unconcerned and careless (cf. Armbrüster in Prölss / Martin, VVG, 29th ed. about sec. 28 recital 5). Insofar as a policyholder ignores any signs of an imminent damage and continues to operate the machine until the damage occurs, the policyholder acts grossly negligent. If, for example, the operator of a wind energy plant detects metal chips in the gear oil, this may indicate a later gear tooth breakage. The later gear

damage is then a foreseen damage. There will then be no insurance cover.

If above assessment criteria are correctly applied, policyholders very seldom act grossly negligently. If, among others, the indications to the later damage (as almost always) are barely recognizable, the policyholder will only misjudge the occurrence of the insured event simply negligently. Insurance cover exists.

#### 4.2.2 Representative

For the question of whether the damage occurred unforeseen, only the knowledge and behavior of the policyholder or its representatives is relevant. Insofar as a representative of the policyholder did not foresee the damage by gross negligence, no insurance cover exists. The attribution of the conduct of a normal employee of the policyholder is not permissible according to sec. 278 BGB (cf. van Bühren in Handbuch Versicherungsrecht, sec.1 recital 363).

According to jurisdiction, a representative is someone, who is entrusted with the risk administration of the machine with the knowledge and desire of the policyholder (cf. BGH r+s 1992, 266).

This may only be someone who is entitled to act independently in a relevant scope with regard to the insured item (cf. Higher Regional Court Hamm, VersR 1995, 1348).

In claims settlement, the classification of employees as representatives on the basis of the aforementioned criteria of jurisdiction can lead to discussions. Insurers sometimes pull the circle of representatives too far in claims settlement. By this, the knowledge of technical employees may for example become relevant for the predictability of damage.

The high technical knowledge of these employees would often speak in favor of predictability. The likelihood that a damage was grossly negligently not foreseen is all the greater the more representatives there are. The policyholder therefore wants to limit the number of representatives to the smallest possible circle of people.

Unnecessary discussions about the classification of employees as representatives can avoid the representative clause. The parties to the insurance contract may denominate the persons who should be representatives by means of the representatives clause. According to the clause, representatives are the managing directors and board members, thus the highest management bodies of the policyholder, but not simple employees (department heads, site supervisors, control center employees, etc.).

Recently observed tendencies of individual insurers who regard the representatives mentioned in the representative clauses only as exemplary, not completed list, is wrong.

#### 4.2.3 Unclear cause speaks for unforeseen damage

If the cause of damage remains unclear during the claims settlement, this indicates the unpredictability of the occurrence of the insured event. The cause of the damage can remain unclear after the damage has occurred. The policyholder does not have to prove the cause in order to obtain the insurance benefit (cf., i.a. Bruck/Möller about sec. 2 AMB, recital 31, Voßkuhler in Beckmann/Matusche-Beckmann, sec. 35, recital 97, Higher Regional Court Karlsruhe, NJW -RR 2003, 891).

#### 4.2.4 Burden of substantiation and proof for unforeseen damage

The policyholder initially only has to assert the unforeseen damage. Only when the insurer substantiates facts that speak against the unforeseen damage, the policyholder has to disprove these facts (cf. Voßkuhler in Beckmann/Matusche-Beckmann, sec. 35, recital 97).

## 5. EXCLUSIONS

The machinery insurance provides cover against risks that might cause damage to the insured machine. Only those risks explicitly excluded in the insurance contract are not insured.

#### 5.1 Burden of substantiation and proof for exclusions

In the insured event, the insurer has to substantiate and prove without any relief that an excluded risk caused the damage. Assumptions (even those that are obvious) of the insurer that the damage was caused by an excluded risk are not sufficient for this proof. If the insurer cannot produce evidence, the policyholder receives the full insurance benefit.

#### 5.2 Delay of claims settlement

Often the claims settlement is delayed by lengthy investigations of the insurer on the alleged participation of excluded, uninsured causes of the damage. These investigations, which are often intransparent for the policyholder, should be limited in time in the insurance contract. The parties may, for example, agree in the machinery insurance contract, that the insurer's investigations of the cause of the damage shall be completed within twelve months after the occurrence of the insured event. If the insurer cannot substantiate and prove

fact of exclusion after a period of twelve months, an insured risk would be assumed.

#### 5.3 Individual exclusions

The following exclusions can be found in numerous insurance contracts.

##### 5.3.1 War, civil war, revolution, civil commotion, terror

Damages caused by war or war-like conditions are not covered by the standard insurance contracts. It is understandable that the insurer does not want to bear the often disastrous consequences of war and war-like conditions. Just as understandable, however, is the interest of policyholders to at least protect themselves from damage caused by civil commotion. Depending on the place of insurance, insurers will be prepared to accept the risk of damage caused by civil commotion (cf., i.a. technical clause 2236 on AMB 2011).

If the insurer excludes the risk of terrorist attacks in the machinery insurance contract, the conclusion of additional cyber insurance with the inclusion of terror may be reasonable. Successful cyber terror attacks pose huge risks, especially for today's digitized industry.

##### 5.3.2 Operational damages

Also damages resulting from operational use of an insured machine are not insured. Such operational damages belong to the operational risk, which insurers usually do not cover.

It has to be differentiated between damages caused directly and indirectly.

Only the damage caused directly by operational use is not insured. The damage has to be in close temporal relation to the operation of the machine in order to be excluded as danger. However, if fur-

ther damage is caused to adjacent parts of the machine as an indirect consequence of an operating damage, this additional damage is in turn insured.

### 5.3.3 Theft

If a machine or part of a machine is stolen, the machinery insurance does principally not provide insurance cover.

If the thief causes damage to the machine by improperly disassembling the machine or a part of the machine, this damage is insured.

## 6. DURATION OF INSURANCE COVER

The duration of insurance cover depends on different factors.

### 6.1 Beginning of insurance cover

The insurance cover does not begin before the time agreed between the parties. The insurance contract regularly states in the insurance policy a date on which the insurance cover can begin at the earliest.

Furthermore, the beginning of the insurance cover requires the machine's readiness for operation. For this, the machine needs to have passed the trial operation successfully.

Before readiness for operation, i.e. during the construction of the machine, the erection insurance provides cover. Erection insurance and machinery insurance regularly merge without any time gaps in coverage.

### 6.2 End of insurance cover

The machinery insurance cover may end in different ways.

#### 6.2.1 Cancellation in case of insured event

The machinery insurance cover may end on the one hand by a termination after the occurrence of an insured event. If the insurer or the policyholder decides after an insured event to terminate the insurance contract, both parties have a right of termination.

After an insured event, insurers regularly examine the future damage potential of the machine. Depending on the result of the examination, insurers sometimes cancel the insurance contract. The policyholder now has to buy new insurance cover at short notice. Due to the damage history, the policyholder can often only receive this new insurance cover at higher insurance premiums. However, due to their machine loan agreements, policyholders are obliged to maintain sufficient machinery insurance cover during the operation of the financed machine. Otherwise, the policyholder violates its loan agreement. Consequently, the policyholder will often be forced to accept insurance contracts with increased premiums after an insured event.

In order to avoid this dilemma after an insured event and to offer the policyholder planning security, the parties to the insurance contract should from the outset exclude the right to cancel the insurance contract in case of an insured event.

#### 6.2.2 Expiry

On the other hand, the insurance cover can end on expiry of the originally agreed insurance period (usually one to five years). For insurance contracts with a term of at least one year, the contract is automatically renewed for one year if none of the contracting parties terminates at the latest three months before the end of the agreed contract term.

## 7. PLACE OF INSURANCE

In order for the policyholder to have a claim for insurance benefits, the damage has to occur at the place of insurance. It is though irrelevant for the insurance claim where the cause of the damage was initiated (Martin, Sachversicherungsrecht Gl recital 4). Thus, the crack on a machine has to occur at the place of insurance. If is not relevant for insurance cover if the cause of the crack (e.g. the awkwardness of a welder) was initiated outside the place of insurance (e.g. in assembly halls).

### 7.1 Designation of place of insurance

The place of insurance should be designated in the insurance policy. This applies in particular if the business premises are not identical with the headquarters of the policyholder and the machine is located at a secondary location. If only the head office of the policyholder is mentioned in the insurance policy, there might be no insurance cover for machines located at the secondary location (cf. thereto also Voßkühler, Beckmann/Matusche-Beckmann regarding sec. 35 recital 213).

## 8. AMOUNT OF INSURANCE PREMIUM

The amount of the insurance premium depends on whether a partial or total damage occurred.

### 8.1 Partial damage

If a partial damage has occurred, the machine insurer owes the policyholder the reimbursement of the recovery costs. The recovery costs correspond essentially to the repair costs. These costs are to be reduced by the value of the waste material resulting from the repair. In addition, the insurer can calculate a value deduction "new for old".

Partial damage means that the cost of the restoration plus the value of the waste material does not

exceed the fair value of the machine at the time the damage occurred.

The fair value corresponds to the replacement value of the insured machine deducted by the value diminished due to wear. The insurance terms often regulate maximum annual time value deductions. For example, the parties often agree that the deduction of fair value per year of use may not exceed five percent of the original value. Consequently, a machine with an original value of EUR 2 million would at least have a time value of EUR 1.6 million after four years in operation.

In so far as the cost of the repair plus the value of the waste material in the example just mentioned does not exceed EUR 1.6 million, a partial damage has occurred. The insurer then owes recovery costs in the amount of EUR 1.6 million deducted the value of the waste material resulting from the repair.

### 8.2 Total damage

If the restoration costs though exceed the original value of the insured machine, a total damage has occurred. In the above example a total damage is given if the repair costs amount to e.g. EUR 1.7 million

In the case of total loss, the insurer must pay a maximum of the fair value of the insured item. This time value must then be reduced by the value of any recoverable residual values.

In case of a total damage, the insurer has to pay a maximum of the fair value of the insured item. This fair value then has to be reduced by the value of any usable residual values.

### 8.3 No obligation to repair

The policyholder does not have to repair the machine to receive the insurance benefit. The policy-

holder can abstractly calculate the damage towards the insurer. If the policyholder calculates the damage without repair, the insurer has to reimburse the amount due for the fictitious repair.

## 9. SUMMARY

The German insurance industry offers policyholders comprehensive insurance cover for machinery. Standard insurance terms do though often not correspond with the specific interest of the policyholder. These standard terms need to be modified.

In claims settlement, lump sum valuations are not sufficient. Very often, the machinery insurance contracts are designed individually. For this reason, every insurance-related question relevant to the claims settlement has to be answered individually on the basis of the agreed clauses.

Please do not hesitate to contact our Head of Property Insurance in case of any further questions:

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