

Machinery Insurance

Insuring machinery and plants

1. INTRODUCTION

Companies transfer the risk of damage of high-quality machinery, plants and devices (in the following referred to as “**machines**”) to insurers. The conclusion of machinery insurance enables companies to reduce financial consequences of damages to machinery. Damages become calculable for companies.

2. ALL-RISK INSURANCE

The machinery insurance contract is a technical property insurance contract, designed as an all-risk insurance contract. The contract insures companies against all risks which might causes damages to machines. Only those risks excluded from the insurance contract as insured risk, are not insured.

3. INSURED OBJECTS

Companies may insure machines, devices and technical plants of all kind (e.g. power plants, bending devices) through a machinery insurance contract.

3.1 Machinery register

The parties should exactly designate the machines in the insurance contract. Machines often consist of several hundreds of components and/or several large components (coal power plant and other coal conveyor systems, mill and coal dryer, combustion chamber, condenser, turbine, generator, cold room). A general designation of the insured object (e.g. as power plant) may in case of a damage to a side plant (e.g. transmission station) arise questions about the factual scope of the insurance contract (e.g. whether the side plant is insured at all).

The exact designation of the machine including all side plants avoids discussions about the factual scope of the insurance contract. The contracting parties usually list insured objects in detail in a machinery register.

3.2 No insurance cover for auxiliary means

Tool and auxiliary means of the machine (e.g. lubricants and fuels) are principally not insured.

4. INSURED RISKS

The machinery insurance contract offers protection against unexpected damages to machinery. Cover exists independent of the damage-causing event (Higher Regional Court Karlsruhe in NJW RR 2003, 891).

The risks listed in the terms to the machinery insurance (e.g. part A sec. 2 cypher 1 AMB 2011) are only examples of insured risks. The list is not final and serves as an illustration of insured risks. The terms list among others damages resulting from operating errors, clumsiness, material- or construction errors or intent of third parties as insured cause of damage.

5. INSURED EVENT

The occurrence of the insured event obliges the insurer to make indemnification payments. The insured event in the machinery insurance requires that the damage to the machine occurs unexpectedly.

5.1 Property damage

The damage has to be damage to property. The machinery insurance covers pecuniary losses only insofar as they are explicitly designated as insured (often acceleration costs in form of overtime premiums of the repair personnel).

Damage to property is given if the substance of the machine has been impacted in such way that the value or the usability of the insured object is at least diminished. The condition of the machinery at least has to be disadvantageously amended in its substance.

A crack or even a slight break at the machinery constitutes impairment to substance which might trigger an insured property damage. It is not required that the amendment

of substance is detectable with the naked eye. Microscopic cracks may be sufficient for a property damage.

Defects of beauty (e.g. damages to paint work at a machine casing) which do not impair the functionality of the machine, do not represent property damages and thus do not justify a claim for insurance indemnification. But if for example paint work at the rotor spalls and the rotation performance and the technical usability of the machine is impaired, this represents more than a defect of beauty and thus property damage is given.

The example shows that the differentiation among a defect of beauty and insured property damage has to be examined separately for each machine. Generalizations are inappropriate.

5.2 Unexpected damage

The property damage has to occur unexpectedly

5.2.1 Gross negligence harms the insurance claim

Damage occurs unexpectedly if the policy holder did not foresee the damage in time. Only gross negligence harms the insurance claim. Gross negligence causes a pro rata reduction of the insurance claim (Part A sec. 2 cypher 1 AMB 2011). The policy holder acts grossly negligent if he does not detect what would be obvious to every policy holder in a comparable situation.

In so far as a policy holder ignores obvious indications of an imminent damage and continues to operate the machine until occurrence of the damage, he acts at least grossly negligent. The insurance claim would exist only partially.

If the indications of damage are hardly recognizable, the policy holder may only negligently not foresee the damage. This is the usual case in practice. Insurance cover existed in its full amount.

5.2.2 Attribution of knowledge of representatives

To evaluate the predictability, the knowledge of the policy holder's representative is decisive. In so far as a representative of the policy holder did grossly negligent not foresee the damage, only a reduced insurance claim exists.

A representative of the policy holder is a person who is entrusted by the policy holder with the risk administration and takes the policy holder's place. This may from the policy holder's company only be a person who is entrusted to act independently to a major extent with regard to the insured machine (cf. Higher Regional Court Hamm in Versicherungsrecht 1995, 1348).

After a damage, the (often incorrect) classification of company employees (managing director, head of department, production employee) as representative may cause discussions between the insurer and the policy holder. Insurers tend to extend the group of representatives. This way it might be possible that e.g. the knowledge of a technical employee of the policy holder speaks in favor of the predictability of the damage and thus against an insured damage.

The policy holder on the other hand wants to limit the circle of representatives to a small number of persons

The discussion about attributable knowledge may complicate and delay the settlement of the claim.

5.2.3 Legal certainty by representation clause

The discussion about the classification of company employees as representatives may be avoided by means of a representative clause. The parties to the insurance contract may appoint persons as representatives at conclusion of the contract. Those are usually managing directors and members of the executive board, and rather not technical managers or other employees.

5.3 Uncertain cause indicates unpredictability

The cause of the damage may remain uncertain after the occurrence of the insured event. The policy holder does not have to explain and prove the cause of the damage. If the cause of damage remains uncertain after the occurrence of an insured event, this indicates the unpredictability of the occurrence of the damage.

6. EXCLUDED RISKS

As mentioned above (cf. 2.) the machinery insurance contract offers insurance coverage against all risks that might cause damage to the insured object. Only those risks excluded by contract are not insured.

In the insured event, the insurer has to explain without any procedural facilitation and if necessary prove that the excluded risk caused the damage. If the insurer is not able to prove this, the policy holder will receive the indemnification payment.

The following exclusions are relevant in practice:

6.1 War, civil war, revolution

Damages caused by war events or warlike conditions are not insured. Machinery insurers do not cover the financial consequences of a war.

6.2 Natural hazards

The insurance terms often exclude coverage for natural hazards such as flood, high water and earthquakes.

6.3 Operational use

Damages resulting from the operation of the insured machine are not insured. The operational use is part of the entrepreneurial risk the machinery insurer will usually not cover.

Only those damages resulting directly from the operational use are not insured. If an additional damage incurs at adjoining parts of the machine as a direct consequence of the operational damage, this damage is insured.

7. INSURANCE LOCATION

The damage has to incur at the insurance location in order for an insurance claim to exist. For the insurance claim it is though irrelevant whether the cause of the damage lies at the insurance location.

7.1 Indication of the insurance location in insurance policy

The insurance location should be indicated exactly in the insurance contract. This applies especially in case the factory premises are not identical with the registered office of the policy holder.

If only the registered office of the policy holder is indicated in the insurance policy and the insured machine is not located at the same address, insurance coverage might not exist.

7.2 Additional transportation insurance

As long as the insured machine (e.g. for repair, revision or maintenance) is not at the insurance location indicated in the insurance policy, usually no machinery insurance coverage exists (cf. Part A sec. 4 AMB 2011). In this case, the policy holder may conclude separate transportation insurance.

8. INSURANCE PERIOD

The insurance period depends on different terms.

8.1 Beginning of insurance coverage

The insurance coverage does not begin before the agreed point of time. The insurance policy indicates a date when the insurance coverage starts earliest.

Further, coverage does not start before the machine is ready for operation. This usually requires a successful trial operation of the machine.

Before the machine is ready for operation, the erection insurance offers coverage.

8.2 End of insurance coverage

The machinery insurance coverage may end in different ways.

8.2.1 Termination after an insured event

The insurance may end due to a termination after the occurrence of an insured event (sec. 92 Insurance Contract Act "VVG"). If the insurer or the policy holder decide to ter-

minate the insurance contract after the occurrence of an insured event, both parties may terminate the insurance agreement.

Insurers examine the future damage potential of a machine after an insured event. Depending on the result of the examination, they sometimes terminate the contract. The policy holder is then confronted with the problem to buy new, acceptable insurance coverage. Due to the damage history, the policy holder will often get insurance coverage only at increased insurance premiums.

If the machinery has been financed by credit, the policy holder is obliged to keep up machinery insurance coverage. If not, he breaches his credit contract. Due to this situation, the policy holder will eventually accept the new, more expensive insurance contract.

In order to avoid this situation, the parties to the insurance contract may exclude the right to terminate the contract in the insured event. The policy holder thus increases his planning security not to be forced to purchase new more expensive insurance coverage after the occurrence of an insured event.

8.2.2 End of insurance period

On the other hand, the insurance contract may terminate when the originally agreed insurance term (usually one to five years) ends.

9. INSURANCE BENEFIT

The amount of the insurance benefit depends on whether a partial or an entire damage has occurred.

9.1 Partial damage

If a partial damage at the insured machine occurs, the machinery insurer owes indemnification of reinstatement costs. Reinstatement costs correspond with usual costs of repair. The insurer may reduce this amount by old material accrued during the repair. In addition, the insurer may deduct the difference in value "new for old".

A partial damage is given if the restoration costs plus the value of the old material does not exceed the fair value of the machine before the insured event. The fair value here

corresponds with the original value of the insured object deducted by the diminished value due to abrasion.

Insurance terms often provide for a maximum annual time value deduction independent of the condition of the machine. Thus, machinery insurance contracts often regulate that the deduction from the fair value for the determination of the time value per year of usage may not be higher than five percent of the fair value.

This means that a machine with an original purchase price of EUR 1 million will in case of an insured event after four years of usage at least have a fair value of EUR 800,000.00 (five percent time value deduction per year x four years of usage = 20 percent time value deduction from the fair value).

If, in above example, repair costs plus value of the old material are not higher than EUR 800,000.00, a partial damage is given. The insurer then owes the costs of repair as reinstatement costs in the amount of EUR 800,000.00 deducted by the value of old material accrued by the repair.

9.2 Total loss

A total loss is given if reinstatement costs are higher than the fair value of the insured machine. In the example (cf. 9.1), a total loss would be given if costs of repair amount to EUR 900,000.00.

In case of a total loss, the insurer owes the policy holder at maximum the fair value of the insured object.

9.3 No obligation to reinstate

The policy holder is not obliged to repair the machine in order to assert the insurance indemnification. The policy holder has the possibility to make an abstract calculation of the damage. In this case, the insurer has to reimburse the objectively required amount which would incur for the fictive repair (reinstatement).

10. SUPPLEMENTARY PROTECTION OF THE BUSINESS INTERRUPTION RISK

The machinery insurance only compensates for property damages. The policy holder's pecuniary loss incurring as a consequence of the property damages is principally not covered by the machinery insurer.

The policy holder will often suffer a pecuniary loss resulting from a production downtime due to the damage at the machine. The loss of profit during the downtime of the machine may be covered by business interruption insurance. The business interruption insurance is often only available in combination with property insurance, here with machinery insurance.

11. CONCLUSIONS

Machinery insurance cover is useful for commercial policy holders who use machines, equipment and plants. If the machine is financed by credit, insurance coverage is obligatory.

The standard insurance terms AMB 2011 often don't fit the individual insurance need of the policy holder and have to be modified when the insurance contract is concluded.

The settlement of the insured event will pass smoothly in those cases where the insurer and the policy holder (and eventually their agent or lawyer) is aware of the comprehensive coverage concept of the machinery insurance as an all-risk policy.

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